

# **NORTH KOREA: ILLICIT ACTIVITY FUNDING THE REGIME**

---

---

## **HEARING**

BEFORE THE

FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT  
INFORMATION, AND INTERNATIONAL  
SECURITY SUBCOMMITTEE

OF THE

COMMITTEE ON  
HOMELAND SECURITY AND  
GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

APRIL 25, 2006

Available via <http://www.access.gpo.gov/congress/senate>

Printed for the use of the Committee on Homeland Security  
and Governmental Affairs



U.S. GOVERNMENT PRINTING OFFICE

28-241 PDF

WASHINGTON : 2007

---

For sale by the Superintendent of Documents, U.S. Government Printing Office  
Internet: [bookstore.gpo.gov](http://bookstore.gpo.gov) Phone: toll free (866) 512-1800; DC area (202) 512-1800  
Fax: (202) 512-2250 Mail: Stop SSOP, Washington, DC 20402-0001

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

SUSAN M. COLLINS, Maine, *Chairman*

TED STEVENS, Alaska	JOSEPH I. LIEBERMAN, Connecticut
GEORGE V. VOINOVICH, Ohio	CARL LEVIN, Michigan
NORM COLEMAN, Minnesota	DANIEL K. AKAKA, Hawaii
TOM COBURN, Oklahoma	THOMAS R. CARPER, Delaware
LINCOLN D. CHAFEE, Rhode Island	MARK DAYTON, Minnesota
ROBERT F. BENNETT, Utah	FRANK LAUTENBERG, New Jersey
PETE V. DOMENICI, New Mexico	MARK PRYOR, Arkansas
JOHN W. WARNER, Virginia	

MICHAEL D. BOPP, *Staff Director and Chief Counsel*

JOYCE A. RECHTSCHAFFEN, *Minority Staff Director and Chief Counsel*

TRINA DRIESSNACK TYRER, *Chief Clerk*

FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, AND  
INTERNATIONAL SECURITY SUBCOMMITTEE

TOM COBURN, Oklahoma, *Chairman*

TED STEVENS, Alaska	THOMAS CARPER, Delaware
GEORGE V. VOINOVICH, Ohio	CARL LEVIN, Michigan
LINCOLN D. CHAFEE, Rhode Island	DANIEL K. AKAKA, Hawaii
ROBERT F. BENNETT, Utah	MARK DAYTON, Minnesota
PETE V. DOMENICI, New Mexico	FRANK LAUTENBERG, New Jersey
JOHN W. WARNER, Virginia	MARK PRYOR, Arkansas

KATY FRENCH, *Staff Director*

SHEILA MURPHY, *Minority Staff Director*

JOHN KILVINGTON, *Minority Deputy Staff Director*

LIZ SCRANTON, *Chief Clerk*

## CONTENTS

Opening statements:	Page
Senator Coburn .....	1
Senator Carper .....	3

### WITNESSES

TUESDAY, APRIL 25, 2006

Peter A. Prahar, Director, Office of Africa, Asia and Europe Programs, Bureau for International Narcotics and Law Enforcement Affairs, U.S. Department of State .....	4
Michael Merritt, Deputy Assistant Director, Office of Investigations, United States Secret Service, U.S. Department of Homeland Security .....	6
Seong Min Kim, Vice Chairman of the Exile Committee for North Korea Democracy, and President, Free North Korea Radio .....	15
David L. Asher, Institute for Defense Analysis .....	17
Chuck Downs, Author, "Over the Line: North Korea's Negotiating Strategy" ...	19
Marcus Noland, Senior Fellow, Institute for International Economics .....	21

### ALPHABETICAL LIST OF WITNESSES

Asher, David L.:	
Testimony .....	17
Prepared statement .....	57
Downs, Chuck:	
Testimony .....	19
Prepared statement .....	69
Kim, Seong Min:	
Testimony .....	15
Prepared statement .....	52
Merritt, Michael:	
Testimony .....	6
Prepared statement .....	49
Noland, Marcus:	
Testimony .....	21
Prepared statement .....	75
Prahar, Peter:	
Testimony .....	4
Prepared statement .....	35

### APPENDIX

Chart submitted for the Record by Senator Coburn entitled "Uncovering Supernotes" .....	33
Chart submitted for the Record by Senator Coburn entitled "Satellite Image of the Korean Peninsula" .....	34
Questions and Responses submitted for the Record from:	
Mr. Phahar .....	86
Mr. Merritt .....	93



## **NORTH KOREA: ILLICIT ACTIVITY FUNDING THE REGIME**

---

**TUESDAY, APRIL 25, 2006**

U.S. SENATE,  
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT,  
GOVERNMENT INFORMATION, AND INTERNATIONAL SECURITY,

OF THE COMMITTEE ON HOMELAND SECURITY  
AND GOVERNMENTAL AFFAIRS,  
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 2:30 p.m., in room SD-342, Dirksen Senate Office Building, Hon. Tom Coburn, Chairman of the Subcommittee, presiding.

Present: Senators Coburn and Carper.

### **OPENING STATEMENT OF SENATOR COBURN**

Senator COBURN. The Subcommittee of the Homeland Security Committee on Federal Financial Management, Government Information, and International Security will come to order. I want to welcome all of our guests. Thank you for being here, those that are testifying, as well.

The Orwellian, so-called “Democratic People’s Republic” of Korea, otherwise known as North Korea, is a rogue nation and one of the most dangerous regimes in the world. North Korea is a closed society under the grip of the ruthless dictator, Kim Jong-Il. From the little we know about this secretive dictatorship, it is clear that there is little the regime won’t do in order to increase its stranglehold of power and its threat to the world.

While the attention of the world is focused on nuclear proliferation in Iran, North Korea is continuing its own dangerous proliferation. Since the last decade, when we heard the same platitudes from North Korea that we are hearing today from Iran—about so-called “peaceful nuclear energy” pursuits—we have instead seen the regime develop nuclear weapons and sell their technologies to Iran and others. Just recently, we’ve heard reports that North Korea shipped missiles to the Iranians. It is my hope that the United States is aggressively working with South Korea and other allies to instigate a rigorous interdiction policy to prevent such devastating shipments from occurring in the future.

But the purpose of this hearing is to explore other facets of North Korea’s agenda beyond weapons proliferation, although, as we will see, these illicit activities are in no way independent of weapons proliferation. The regime of Kim Jong-Il, including its own nuclear program as well as its support of terrorist states, receives much of

its funding from a vast criminal network of state-sponsored illicit activity. North Korea engages in drug trafficking, counterfeiting of U.S. currency, counterfeiting of products, including pharmaceuticals, and slave labor producing goods it then exports, and also slave labor in foreign countries.

The unclassified information that we know about these activities leaves no doubt that they are, in fact, state-sponsored. In the criminal cases that have been made public, North Korean diplomats and state-owned companies were directly involved in activities such as narcotics trafficking and money laundering. Testimony from North Korean defectors describes with great detail the horrifying conditions of the political prisons and concentration camps inside of North Korea and the forced-labor farms and factories that are owned by the North Korean Government and operated in places like the Czech Republic, Russia, Libya, Bulgaria, Saudi Arabia, and Angola.

The income from these illicit activities is substantial and provides a reliable revenue stream supporting the regime's weapons programs, both internal and with its terrorist allies. Experts say that this state-sponsored criminal network is generating between \$500 million and \$1 billion annually. With income this substantial, it is easy to see why the North Korean regime is still able to pursue its proliferation agenda despite sanctions and isolation.

Drug smuggling, counterfeiting, and slave labor are integral to sustaining the regime's agenda, including bolstering the power of the government, maintaining oppressive control over its citizens, feeding and equipping an enormous military force, and continuing nuclear weapons proliferation. By cracking down on this illicit activity, the United States could substantially erode this economic "crutch" which enables the regime to remain hostile and unresponsive at the Six Party negotiation table.

It is imperative that our North Korean policy is comprehensive—utilizing all intelligence, all government expertise and leverage, and implementing every statutory tool at our disposal to protect Americans, South Koreans, and other allies, and even the unfortunate innocent Korean population from the dangers of Kim Jong-Il's tyrannical rule.

This week is North Korean Freedom Week. Some of our witnesses and many of those who helped us in preparing for this hearing are people who courageously defected from North Korea at great personal peril. I would like to take a moment to honor these men and women by recognizing those who have joined us today and ask them to rise from their seats.

All of you have made a tremendous sacrifice to be here today—many of you have left behind your spouse, children, family, and friends. It is our goal here today to ensure that you have not made this sacrifice in vain. Thank you so much for your courage.

[Applause.]

Senator COBURN. Behind Senator Carper, you will see a satellite photo which I keep on my desk at all times. It is under my glass on my desk in my personal office. It is a photo of the Korean peninsula, taken at night by satellite. The South is all lit up with the light of economic development—infrastructure for electricity and

industry literally makes the terrain glow in the dark from the satellite's point of view.

Just a few decades ago, South Korea was as poor as some of the poorest countries in the world. Now, it is an economic powerhouse that has joined the world community and brought democracy and a high standard of living for its citizens.

Above South Korea, the rest of the peninsula is pitched in black—no development, no infrastructure, no industry, no hope, no future. It is a stark reminder I like to keep for myself about the intangible fruits of freedom, economic development, the rule of law, and a government accountable to its citizens. No amount of black-market thuggery such as counterfeiting, narcotics production, and trafficking in persons, will bring light to North Korea.

I hope that today's hearing can remind us that when people are ruled by force and deprivation, by fear and oppression, when their God-given freedom is suppressed, the soul of the nation, like its topographical satellite image, is trapped in darkness. But we are not helpless. America can make a difference in the darkest corners of the earth as America always has. Our security depends on it.

I want to end as I began, with a reference to George Orwell, who once said, "In an age of universal deceit, telling the truth is a revolutionary act." I hope today we will peel back the veil and tell the truth about North Korea.

I want to thank again all our witnesses for being here today. I look forward to your testimony.

I would like to recognize my Co-Chairman and partner in our oversight duties, the Senator from Delaware, Tom Carper.

#### **OPENING STATEMENT OF SENATOR CARPER**

Senator CARPER. Thanks, Mr. Chairman. It is great to be with you again, and to our witnesses today, welcome. To our special guests, a very special welcome to each of you.

As our Chairman has said, this is a week that we also think of as North Korean Freedom Week. I think the idea of scheduling a hearing—I don't think this is just a coincidence, but the idea of scheduling a hearing that can offer some insights into a way to get North Korea back to the negotiating table where human rights, where humanitarian aid, and our nuclear weapons concerns can be discussed could not be more timely.

North Korea's public declaration in 2005 that it had a nuclear deterrent confirmed what many believed was already the case and why U.S. strategic interests and foreign policy in the Asian-Pacific region should be elevated. Since 2002, North Korea claims to have reprocessed enough spent fuel to yield between eight and ten nuclear weapons. In addition, U.S. officials maintain that North Korea is pursuing uranium enrichment for a nuclear weapons program using technology apparently sold them by Pakistani scientist A.Q. Khan.

In September, a breakthrough was made in getting North Korea to agree to relinquish its nuclear arsenal and related capabilities in exchange for aid through these so-called Six-Party Talks. However, since that monumental agreement, the Six Party Talks have been on hiatus. I am told that this hiatus is in part due to North Korea's affront to the U.S. Treasury Department's designation of a

bank in the region as a front for North Korean counterfeiting operations at the exact moment in which the talks were moving forward.

In any event, today's hearing is important in determining the North Korean Government's role in counterfeiting, their role in drug trafficking, and their role in other illicit activities, but more importantly, to what extent these activities are used to support North Korea's nuclear weapons program.

Today's hearing is also important for determining what role U.S. efforts to target North Korean illicit activities should play. I think it is easy to argue that the United States and the international community should act to prevent North Koreans from selling illicit drugs and passing counterfeit currency because they are detrimental to the U.S. economy and, in general, really, to society. However, I think it is also important to consider how our focus on these activities could be instrumental in getting North Korea back to the bargaining and negotiating table.

Again, we look forward to the testimony of these witnesses and others that will come before us today. Thank you for joining us, and Mr. Chairman, I thank you for convening this hearing.

Senator COBURN. Thank you, Senator Carper.

Our first panel will be recognized. I would ask all our witnesses to limit their oral testimony to 5 minutes. Your complete written statement will be made a part of the record and we will hold our questions until the entire panel has given their testimony.

First, let me introduce Peter Prahar. He is a member of the Senior Foreign Service and is now serving at the State Department as the Director of the Office of Asian, African, and European Programs in the Bureau for International Narcotics and Law Enforcement. He was the Deputy Director of that office from 2001 until 2003.

Michael Merritt was appointed Deputy Assistant Director of the Office of Investigations at the Secret Service in 2005. His areas of responsibility include the Criminal Investigative Division, the Investigative Support Division, the Forensic Services Division, and all foreign offices for the U.S. Secret Service.

Thank you, Mr. Prahar, and you are recognized for 5 minutes.

**TESTIMONY OF PETER A. PRAHAR,<sup>1</sup> DIRECTOR, OFFICE OF AFRICA, ASIA AND EUROPE PROGRAMS, BUREAU FOR INTERNATIONAL NARCOTICS AND LAW ENFORCEMENT AFFAIRS, U.S. DEPARTMENT OF STATE**

Mr. PRAHAR. Mr. Chairman, thank you for the opportunity to appear today before you to discuss narcotics trafficking and other criminal activity with a connection to the Democratic People's Republic of Korea, the DPRK, and what actions the Department of State is taking to address these activities. Please allow me to briefly summarize the material in my written statement.

Let me begin by stating that there is no doubt that the government of the Democratic People's Republic of North Korea, the Korean Workers' Party, and the Korean People's Army are all involved in criminal activity in order to, we believe, obtain hard cur-

<sup>1</sup> The prepared statement of Mr. Prahar appears in the Appendix on page 35.



rency. We are well aware of the possibility that DPRK's state-directed criminality could contribute to the financing of DPRK weapons development by a state that is listed as a state supporter of terrorism and could offer financial support to a state that is otherwise failing economically. The profit realized from these illicit activities could be an important source of funds for the regime and its leadership, although given the covert nature of these activities and the challenge of obtaining reliable information on the DPRK, any estimates are necessarily highly speculative.

My colleague from the U.S. Secret Service will discuss the production and distribution of counterfeit U.S. currency, which is taking place with the full consent and control of the North Korean regime. This is a crime and a very serious one.

Additionally, security enforcement investigators for major American, British, and Japanese cigarette companies have concluded after extensive investigation that at least one factory located in the DPRK manufactures and trafficks in counterfeit cigarettes. There are reports of as many as 12 such factories, some of which appear to be owned and operated by North Korean military and security organizations, while others appear to pay the DPRK for safe haven and access to transportation infrastructure to conduct their criminal activities. These factories have the capacity to produce billions of packs of counterfeit cigarettes annually.

This criminal activity extends to the United States itself. Industry investigators report that from 2002 through September 2005, DPRK source counterfeit Marlboro cigarettes, for example, were identified in 1,300 incidents in the United States.

Finally, there are also indications, as yet rather sketchy, that North Korea has entered the enormously lucrative market for counterfeit pharmaceuticals.

With regard to narcotics production and trafficking, however, the evidence we have to date is somewhat less conclusive. As we have reported, over a period of 30 years, officials of the DPRK have been repeatedly apprehended for trafficking in narcotics and engaging in other criminal activity, such as passing U.S. currency and trafficking in endangered species. In my written statement, I have also given several examples of cases in which state-owned assets, particularly ships and even military patrol vessels, have been used to facilitate and support international drug trafficking ventures. This list is meant to be illustrative rather than exhaustive. Others have compiled and placed in the public record lists of numerous incidents involving the DPRK.

Although there have been no public reports of specific incidents linking the DPRK to narcotics trafficking since 2004, given DPRK involvement in other forms of state-directed criminality and the authoritarian centralized nature of the DPRK state, the Department of State retains the view it stated at the 2005 International Narcotics Control Strategy Report that it is likely, but not certain, that the North Korean Government sponsors criminal activities, including narcotics production and trafficking "as a way to earn foreign currency for the state and its leaders."

What is the Department of State doing about DPRK illicit activities? First, the Department is working through the Illicit Activities Initiative to ensure that information available in law enforcement

channels is compared and coordinated with information available in diplomatic and military channels. This interagency coordination mechanism is working. For example, the Illicit Activities Initiative Working Group on Illicit Finance coordinated the sharing of intelligence that led to the Treasury Department's designation last September of a bank in Macau, Banco Delta Asia, as a primary money laundering concern pursuant to Section 311 of the USA PATRIOT Act, primarily based on its links to North Korean Government agencies and front companies involved in illicit activities.

On the diplomatic front, the Department of State has alerted our allies and friends to the possibility of state-led criminality by the DPRK and encouraged a vigorous law enforcement response. Major narcotics seizures by Taiwan and Japanese authorities demonstrate the commitment and capacity to control this. And we have made it clear to the North Koreans and other countries involved within the context of the Six Party Talks that outstanding bilateral issues, including DPRK's involvement in illicit activities, need to be resolved before we can normalize our relations.

The Department of State continues to work with and acknowledges the critical work being done by other agencies of the U.S. Government in combating North Korean illicit activities.

In closing, I would like to thank you, Mr. Chairman, for this opportunity to discuss this issue. Focusing the public spotlight on this aspect of DPRK state behavior is one of the ways to increase the risk and deter such criminal activity in the future. I am happy to answer your questions.

Senator COBURN. Mr. Prahar, thank you very much. Mr. Merritt.

**TESTIMONY OF MICHAEL MERRITT,<sup>1</sup> DEPUTY ASSISTANT DIRECTOR, OFFICE OF INVESTIGATIONS, U.S. SECRET SERVICE, U.S. DEPARTMENT OF HOMELAND SECURITY**

Mr. MERRITT. Mr. Chairman, I would like to thank you as well as the distinguished Ranking Member and other Members of the Subcommittee for the opportunity to address you today regarding the Secret Service's investigative efforts into the production and distribution of high-quality counterfeit U.S. currency, Federal Reserve Notes, which in this case are collectively referred to as the Supernote.

The worldwide use of the U.S. dollar as the currency of choice continues to grow. With as much as two-thirds of the approximately \$750 billion of U.S. currency in circulation outside of our borders, the U.S. dollar is truly a global currency. In addition to dollarized economies—those nations that have adopted the U.S. dollar as their own currency—businesses and individual interests worldwide depend upon the integrity and stability of the U.S. dollar.

This is why counterfeiting activity can have a profound effect on not only our economy, but the international markets, as well. Counterfeiting reduces consumer confidence in our currency and has the potential to affect the perception, and thereby the strength, of the dollar in all dependent economies.

---

<sup>1</sup>The prepared statement of Mr. Merritt appears in the Appendix on page 49.

The Supernote family of counterfeit notes was first detected in 1989. Since its initial discovery, the investigation into its origin and distribution has been a top priority for the Secret Service. The Supernote investigation is an ongoing strategic case with national security implications. This investigation has spanned the globe, involving more than 130 countries and resulting in more than 170 arrests.

Through extensive investigation, the Secret Service has made definitive connections between these highly deceptive counterfeit notes and the Democratic People's Republic of Korea. Our investigation has revealed that the Supernote continues to be produced and distributed from sources operating out of North Korea.

The Secret Service has seized approximately \$50 million of the Supernote globally, which equates to seizures of approximately \$2.8 million annually. To provide a frame of reference, during the fiscal year 2005, the Secret Service seized over \$113 million in counterfeit U.S. currency.

The high quality of these notes and not the quantity circulated is the primary concern for the Secret Service. The Supernote primarily circulates outside of the United States. The Supernote is unlikely to adversely impact the U.S. economy based upon the comparatively low volume of notes passed. However, the introduction of the Supernote into a micro economy can have a significant influence not only due to the monetary losses sustained as a result of the Supernote passes, but also because of the loss of integrity of the U.S. dollar.

It should be noted that the Supernote, while highly deceptive, is detectable with minimal training. There are also machines which are commercially available that can detect the Supernote.

Throughout the 1990s, numerous North Korean citizens traveling throughout Europe and Asia working in an official capacity were apprehended by law enforcement for passing large quantities of the Supernote. In each of these cases, the North Korean officials evaded prosecution for these crimes based upon their diplomatic status.

The Secret Service has developed and employed a three-prong strategy to address the distribution of this counterfeit. The first part of the strategy focuses on containment based on an aggressive investigative response to all appearances of this counterfeit currency. Secret Service agents posted around the world work closely with their foreign counterparts to identify and arrest distributors of this counterfeit as rapidly as possible.

The second part of our strategy focuses on disruption. With the support of the international law enforcement community through Interpol, this strategy is designed to deny North Korea the supplies and equipment required to manufacture high-quality counterfeit notes.

The third part of our strategy focuses on education. The Secret Service provides detailed training seminars to financial institutions and law enforcement personnel across the globe on the detection of counterfeit currency.

Mr. Chairman, that concludes my prepared statement and I would be pleased to answer any questions that you or other members of the Subcommittee might have. Thank you very much.

Senator COBURN. Thank you, Mr. Merritt.

Mr. MERRITT. Yes, sir.

Senator COBURN. Mr. Prahar, who is the present director of the Illicit Activities Initiative and who does that director report to?

Mr. PRAHAR. The Illicit Activities Initiative I referred to in my written statement as well as my oral statement is, in the current form, building on work previously done by a group called the North Korea Working Group. The participants, there are about two dozen participants in this Illicit Activities Initiative program. They are organized in five specialized interdepartmental committees dealing with smuggling, narcotics trafficking, money laundering, counterfeiting, as well as abuses of diplomatic privileges. These committees are directed by the Department's Office of Korean Affairs in the Bureau of East Asian and Pacific Affairs and they have a direct reporting chain to senior officials in each member agency. I believe that answers the question.

Senator COBURN. But there is not one individual who reports directly on that, or that is in charge of that working group?

Mr. PRAHAR. The Director of the Office of Korean Affairs reports to the Assistant Secretary of State for East Asia and Pacific Affairs, sir.

Senator COBURN. And the group is currently meeting? Do you have—

Mr. PRAHAR. The current group meets very actively.

Senator COBURN. And you answered the questions on who that group is. Has the State Department considered appointing a North Korean czar that operates in the Secretary's office and coordinates with all the pertinent agencies and foreign allies to create a comprehensive policy on North Korea, including the WMD proliferation? Has that been considered, or is that ongoing? Can you teach us a little bit about that?

Mr. PRAHAR. Certainly, Senator. The suggestion is an interesting one. The Illicit Activities Initiative—as it is currently operating and constituted—we believe is a model, frankly, of interagency cooperation. I cited one example of success involving Treasury Department's Section 311 designation of this bank in Macau.

On the theory of if it isn't broke, we won't fix it, we don't believe this is a broken process. We believe it is mobilizing the resources and the expertise and the legal authorities throughout the U.S. Government to deal with this very serious problem we have in North Korea. The answer, of course, again, goes back to who is responsible within the Department of State for affairs within East Asia and the Pacific. It is the Assistant Secretary for East Asia and Pacific Affairs and the Secretary of State.

Senator COBURN. Thank you. Is it possible to bring indictments against Kim Jong-Il and his high-level government officials in charge of the regime? One of the things that hasn't been said but has been referred to: There are violations of international law here, as well.

Mr. PRAHAR. We regularly and systematically review intelligence about all suspected narcotics traffickers and entities in the world, including North Korea. We have not yet gotten sufficient information to designate any North Korean individuals or organizations under the Kingpin Act. An indictment would require probably a

certain level of evidence that I don't believe exists. You might wish to direct that question, though, to the Department of Justice.

Senator COBURN. OK. Is there enough information to put North Korea under the drug majors category?

Mr. PRAHAR. No, sir. That is another item that we consider on a regular basis within the Department of State. As you know, a country can be put on the majors list for basically two reasons. First of all, it is producing 1,000 hectares or cultivating 1,000 hectares or more of opium poppy or coca. We have been unable to confirm reports that we have received over time that there is significant opium poppy cultivation in North Korea, so we have been unable to consider North Korea for placement on the majors list for its involvement as a major cultivator or drug producer.

The other way to get on the majors list is as a major drug transit country having a significant impact on the United States. We have no information of drugs entering the United States through North Korea, although we are very concerned about the possibility of that happening, especially given the apparently well-established cigarette smuggling networks that are in place. We certainly can't meet the threshold requirement of demonstrating a significant impact on the United States.

But this is something, Senator, that we consider regularly within the Department of State. If we have information that will substantiate that finding, that is a recommendation we are going to make.

Senator COBURN. Is there some thought that there is a new direction for the drug trafficking coming out of North Korea rather than from North Korea directly? Would you comment on that?

Mr. PRAHAR. Yes. We have not noticed or detected any major drug activity with a DPRK link since 2003 when a vessel named the Pong Su was stopped by Australian authorities off the coast of Australia. There are many explanations or possible explanations for that.

One is perhaps that the North Korean regime has decided to follow the path of the least resistance and make its money through illicit activities by counterfeiting currency, counterfeiting cigarettes, and counterfeiting drugs. These are enormously lucrative and don't have some of the problems associated with them that large-scale state-directed narcotics trafficking would certainly have.

Another possible explanation is, as you suggested, that there has been a change in trafficking networks from maritime-based efforts to take drugs to drug markets or deliver them to organized Asian criminal groups to using land borders and moving product to Asian organized trafficking groups across land borders, which would be less visible to us. So there are a couple of possible explanations why we haven't seen significant drug activity since 2003.

Senator COBURN. Thank you. My time has expired. Senator Carper.

Senator CARPER. I had to step out of the room and take a phone call from one of our colleagues over in the House of Representatives, so I apologize for missing your testimony. I have glanced through it, though. Would you start off by outlining for us the different forms of criminal activity that we have associated with North Korea? They include drug trafficking, counterfeiting currency, maybe trademark violations, but just kind of go through the

list, if you will, and then I am going to ask you to come back and see if you can maybe not quantify them, but at least give us some idea what the magnitude of importance one is over the other.

Mr. PRAHAR. Certainly, Senator. I would say there are probably five major categories of criminal activity that have been associated with the DPRK. In my testimony, I spoke of the counterfeiting of U.S. currency, and Mr. Merritt has done that, as well.

A major source of income to the regime and its leadership, we believe is the counterfeiting of cigarettes. This is a potentially enormously lucrative business, again with a U.S. connection and, of course, these cigarettes have shown up in Asian markets, as well.

We also see, as I said in my testimony, some sketchy evidence that the DPRK is also counterfeiting pharmaceuticals. This is something that we are watching very carefully. We will work with industry to develop accurate information about it, as we have with the cigarette industry, to deal with and report.

There are a number of incidents involving trade in endangered species. These typically involve North Korean diplomats or state enterprise employees, whatever, stopped at one international border or another with something that is a covered product of the Convention on Endangered Species, the CITES Agreement.

And finally, the issue of drugs. As I said, the evidence with regard to state-directed drug production and trafficking is less conclusive than in some of the other categories that I have discussed.

Senator CARPER. Now, the second half of my question was—and I thank you for that enumeration. The second half of my question was giving us some idea of what the magnitude in terms of relative importance of each of those categories might be.

Mr. PRAHAR. Any assessment of the value of a criminal activity to the DPRK is just necessarily highly speculative. We have seen and heard, as Senator Coburn had, estimates that the total value of this business is \$500 million to \$1 billion. I certainly can't confirm that today.

What I can say is it appears from what we understand about the cigarette counterfeiting that it may be the single most lucrative item in their portfolio.

Senator CARPER. I am sorry, which one?

Mr. PRAHAR. Cigarette counterfeiting. Again, our information with regard to pharmaceutical counterfeiting is very sketchy. We can't even begin to put an estimate on the value of that. Mr. Merritt has spoken about counterfeiting of U.S. currency and the U.S. Secret Service has taken some \$50 million in U.S. currency out of circulation since 1989. The value of trade in endangered species, again, almost anyone's guess on what that could amount to.

And finally, probably the most controversial and difficult thing to get to is the value or the possible value of narcotics production and trafficking. We don't know how much, if any, illicit drugs are produced in North Korea. If opium poppy is being grown, we don't know the yield of those fields so we don't know how much opium gum is generated by these yields. We don't know how much of this opium gum is actually used for what could be considered legitimate purposes, such as pain killers for the Korean People's Army. We don't know how much is actually entering, if any, the illicit trade, or what value the North Koreans may be getting in selling these

drugs to organized crime groups. In general, we know that cultivators and producers at the lower end of the drug chain don't reap the huge profits and value that people do distributing at retail. North Koreans are not distributing the drugs at retail.

So unfortunately, I think the honest answer that people can give is it is very difficult and a highly speculative process trying to assess the value of these illicit activities.

Senator CARPER. Is it likely that any time soon we will have a better idea what the nature of those activities are and the magnitude of them?

Mr. PRAHAR. We watch this issue extremely carefully and, as you know, there have been some Federal indictments filed on both coasts recently. Ongoing investigations and prosecutions of this type may reveal additional information about this. We believe that these funds, as I said in the testimony, could be supporting weapons of mass destruction development and otherwise supporting a tottering regime and the leadership elite of that country. So it is a matter of great concern.

Senator CARPER. I would like to come back maybe in a second round and pursue that, if we could, but thanks so much for responding to those questions.

Senator COBURN. Mr. Merritt, would you explain to us how the PATRIOT Act is involved in operations to combat counterfeiting and trafficking? What specific aspect of that Act has allowed you, for example, in Macau to identify and then put a bank on notice or on a list that will lessen its impact in terms of trafficking?

Mr. MERRITT. Actually, Mr. Chairman, the Treasury Department makes that determination. We were fortunate in that we were the recipients of the Section 311 instituted by the Treasury Department in the Macau bank in China. There was an incident prior to that with the involvement through a series of transactions of a deposit of \$600,000 in the Supernote into one of these accounts, the Taehung Trading Company, which is a Korean Workers' Party-sponsored company. Two diplomats were detained for that and then a search incident to arrest at the Taehung Trading Company. Other Supernotes were found. Again, because of the diplomatic status, nobody was arrested. But as far as that having affected our investigation at the time, sir, that came later. But I think it is one of the reasons they did use for that particular approach.

Senator COBURN. Tell me what other agencies the Secret Service works with besides the State Department in order to combat this counterfeiting by North Korea.

Mr. MERRITT. I would say that for us, obviously, our authority and the jurisdiction we have to investigate counterfeiting stops at our borders, per se, the authority given us by Congress. Now, because this has been such a protracted, lengthy investigation spanning 16, almost 17 years, we have depended heavily on our foreign law enforcement counterparts. Most of the Supernotes circulate outside of the United States. We have depended mostly on them.

Now, recently, we have been partners in some investigations involving some of the aspects with the FBI of counterfeiting cigarettes, but primarily, counterfeiting is—we pretty much work it based on our 141 years of expertise and experience.

Senator COBURN. One other thought. The reports that we have read or looked at say that North Korea obtained most of their counterfeiting technology from European sources. Is there anything that the Secret Service can do to protect the currency and technology that is possessed by foreign companies? Is there anything that we in Congress can do to help give greater protection to that technology not falling into the hands of somebody who is going to use it inappropriately?

Mr. MERRITT. Interesting question, Mr. Chairman. Part of the strategy that we have employed in combating counterfeiting, as I mentioned, there are three strategic, three different approaches: Aggressive investigative technique, the education for the general public and businesses on how to identify counterfeit currency. The third one that I mentioned earlier was, in fact, disruption, and we have through our foreign law enforcement community, through Interpol, as well, enacted what we call to be a disruptive part of our strategy.

Interpol, on our behalf, enacted what we call the Orange Alert, which put on notification the 184 member countries of Interpol that North Korea was producing counterfeit U.S. currency and have encouraged the private industry all over the world, but mainly European, to refrain voluntarily from providing North Korea with printing supplies and printing equipment.

Senator COBURN. Mr. Prahar, we had numerous testimonies from North Korean defectors that tell of slave labor factories and farms that are owned by the North Korean regime but located in places outside of North Korea, like Poland, the Czech Republic, Russia, Bulgaria, Saudi Arabia, and Angola. What is happening within the State Department in terms of our relations with these other countries to combat this form of human trafficking?

Mr. PRAHAR. Senator, my office deals with law enforcement and narcotics matters exclusively. I will have to take the question and—

Senator COBURN. OK. We will submit that for the record. We would appreciate it if you could pass that on up the line.

Mr. PRAHAR. Yes.

Senator COBURN. Senator Carper.

Senator CARPER. Thank you. This could be for either witness. Mr. Merritt, why don't you take the first shot at it, if you would. In your opinion, what has been the impact of U.S. efforts to target counterfeiting and drug trafficking, some of the illegal activity that Mr. Prahar was talking about earlier? What has been the impact on North Korean involvement in the Six Party Talks, to your knowledge? And is your work guided by or in concert with Six Party Talks negotiations?

Mr. MERRITT. Sir, I really wouldn't know whether the impact of our efforts to combat counterfeiting produced in North Korea have impacted the Six Party Talks. I think that is probably—I hate to pass it to you, but it is all yours. [Laughter.]

Mr. PRAHAR. The matters we are discussing are law enforcement matters affecting the security of the United States, even global security. They are being handled as law enforcement matters in the United States by the U.S. Government. Investigations are undertaken and proceed at the pace that they proceed, and when they



are ready, we bring them to the indictment stage and seek prosecution. Examples are, for example, the recent Royal Charm case, which has gotten a lot of press attention. It extended over many years and finally, with some extremely creative and even courageous activities by the FBI.

This type of activity, we have made clear to the North Koreans, will continue. It is not negotiable. It is not tied in any way to the objectives of the Six Party Talks.

Has it had an impact? Yes. As you are aware, the North Koreans are stating they will not return to the Six Party Talks until their money that was frozen in the Section 311 designation action in Macau is returned. Again, we say to the North Koreans that is a law enforcement or regulatory matter. An investigation of that bank's activities is proceeding and the chips will fall where they may when they may.

Since this is North Korean Freedom Week, perhaps I should mention that in these Six Party Talks, the United States and its partners have placed a very attractive offer on the table for the DPRK if it chooses to abandon its nuclear weapons program, illicit activities, and proliferation, including sales of missiles and missile technology. We are prepared to resume negotiations at any time the DPRK decides it wishes to begin implementing its commitments to denuclearize, which it undertook in the context of the September 19 joint statement, and to begin to receive the international economic, diplomatic, and security-related benefits to which it is entitled in exchange for denuclearization and cessation of reliance on proliferation and illicit activities. That is the position of the U.S. Government.

Senator CARPER. Maybe you said it and I missed it. To what extent when these Six Party Talks are going on do they talk about counterfeiting, do they talk about trademark infringements? To what extent do they talk about illicit drugs? And if they bring them up, what is the reaction of North Korea?

Mr. PRAHAR. In the Six Party process, the United States and all of its partners in this process have made it clear to the North Koreans that if North Korea wishes to return to the community of nations, it must give up its illicit activities.

Senator CARPER. I am told that South Korea and China at various times have protested, or at the very least not supported the efforts of this government, our government, to stop illicit activity, and I would ask if that is true, why do you think they are taking those positions amongst the Chinese and the South Koreans? And I would like to ask if you think our efforts will have the potential to negatively impact legitimate business or the economy of that region.

Mr. PRAHAR. OK. Well, the United States is working with all its Six Party partners, including South Korea, on this issue, and all of us agree that the DPRK must abandon illicit activities if it wishes to normalize its participation in the international state system.

With regard to South Korea specifically, the South Korean Government vigorously investigates criminal activities within its own borders including those attributable to the DPRK and cooperates with U.S. law enforcement, for example, in a recent case involving

counterfeit U.S. currency sourced to the DPRK and in another case involving DPRK sourced counterfeit cigarettes.

With regard to China, again, they would agree with us that North Korea must cease its illicit activities if it wishes to rejoin the international community. The Chinese, to be perfectly honest, hold the position that economic reform, economic development and engagement are perhaps a better way to go about dealing with the problem of North Korea and illicit activities. However, our discussions with the Chinese on this subject continue with a view towards developing actionable intelligence regarding these activities. And, in fact, the Chinese do cooperate with us on at least a limited level. For example, in the investigation of the bank in Macau that was designated under Section 311, they have cooperated with us on that one. Senator, there is a divergence with the Chinese on this.

Senator CARPER. My time has expired. Mr. Chairman, I have some questions I would like to submit for the record if there is not another round here.

Senator COBURN. I think for us to expedite our hearing, we will ask that you respond to questions that come from the Subcommittee within 2 weeks. We would very much appreciate you hanging around and hearing our other witnesses if you have the time to do so. Thank you both very much.

I want to welcome our second panel. Let me introduce them to you. Mr. Kim Seong Min is a former writer for the North Korean military until he defected to South Korea in 1999. He has a Master's degree from Tumong University [ph.]. He currently is the Vice Chairman of the Exile Committee for North Korea Democracy, President of Free NK Radio, and President of the Association of North Korean Defectors.

Dr. David Asher is currently an adjunct research staff at the Institute for Defense Analysis, previously served at the Department of State as the coordinator of the North Korean Working Group. He also served as the Director of the Illicit Activities Initiative to combat North Korean criminal activity. This group involved law enforcement officers, intelligence analysts, and policy makers among 14 U.S. Government departments and agencies as well as 15 foreign government partners.

Chuck Downs' career in defense and national security issues spans three decades. He served as Deputy Director in the East Asia office of the Pentagon's International Security Affairs Division. Earlier, he held positions of Assistant Director in the Office of Foreign Military Rights Affairs and as Chief of Policy Analysis at the Department of the Interior's Territorial and International Affairs Office, both of which involved significant international negotiations.

Next is Dr. Marcus Noland, who was educated at Swarthmore College and the Johns Hopkins University, from which he obtained a Ph.D. He is currently a senior fellow at the Institute for International Economics. He was senior economist at the Council of Economic Advisors in the Executive Office of the President of the United States and has held research and teaching positions at several U.S. and international universities.

Mr. Kim, we would like to recognize you first. Please limit your time to 5 minutes.

**TESTIMONY OF SEONG MIN KIM,<sup>1</sup> VICE CHAIRMAN, EXILE  
COMMITTEE FOR NORTH KOREA DEMOCRACY, AND PRESI-  
DENT OF FREE NORTH KOREA RADIO**

Mr. KIM. [through interpreter] A territory may belong to a state, but the state is not immune from the universal roles and values. Nevertheless, Kim Jong-Il's regime since his father's time continues to refuse to abide by such universal roles and values.

There has been much illicit activity carried out by Kim's regime. However, the whole truth has not been receiving much spotlight in the world community until recently. As a true dictatorship, Kim's regime has total control of the press. Attempts by international press, such as the U.N. and the Reporters Without Borders, to bring out the truth have been thwarted by the dictatorship.

We have various organizations representing North Korean escapees. There are approximately 8,000 escapees in South Korea and about 200,000 in third countries, including China. From the escapees, the world is finally hearing the truth, the stark realities facing the people of North Korea.

We now know the truth about the dictatorship. We are hearing about the human rights abuses, the drug trade, counterfeit production, and weapons of mass destruction, and all these are being carried out by the dictatorship in Kim's regime.

There is a firsthand account of Song-Jong Kim, who had been forced to work in a reeducation camp for 10 years in North Korea. He tells of witnessing the death of over 1,000 inmates during that time. These were directly related and due to the harsh working conditions at the so-called reeducation camp.

We have heard from Ms. Keum-Soon Choi during North Korea Human Rights Forum in November of year 2005. Keum-Soon Choi was incarcerated in a political prison for 10 years in North Korea. She was subjected to heavy labor on a daily basis. Her daily meal consisted of less than 100 seed count from maize, supplemented with salt soup, and during rice planting seasons in the province of Pyung-An Nam Do, she testified that she would work from 4 a.m. in the morning to 10 at night, and she testified that she had witnessed the death of 12 of her cellmates during this time period because of the harsh conditions.

There are about 10 political prisons and about 20 reeducation camps, and forced labor subjects, all men, women, young and old alike, and through this forced labor, North Korea manufactures bicycles, munitions, and other commodities.

Cultivation of opium in North Korea is no exception. Kim's regime started a large-scale opium cultivation operation in the provinces of Hamhaebuk-do and Hamkyungbuk-do. All these started in 1983, and retired soldiers are forced into labor on these cultivation fields by the direct order of the Supreme Commander.

It would not be possible to discuss all the atrocities taking place inside the iron veils of North Korea. That would take many days and nights. Even then, that would not be sufficient. Instead, I would like to conclude my remarks by telling you about a writing by a teenager escapee.

<sup>1</sup>The prepared statement of Mr. Kim appears in the Appendix on page 52.

The teenager was 13 years old when he was forced to work on a farm under the guise of farm support. The work on the farm was heavy for this youngster. The work would have been difficult even for a grownup. One day, the teenager found intestines to a goat in a trash dumpster. They were thrown away by soldiers. After washing the intestines 20 times or so, the stench became mild. After boiling the intestines three times, they were somewhat edible. He shared the intestines with his sister. He stated in his writing that the goat intestines were the most delicious things in the world. His writing made big news in South Korea. It also exposed the dark realities of North Korea.

The North Korean regime forces young children to the fields under the guise of farm support. During the spring, children are sent to the fields for 40 days. During autumn, they are subjected to 30 days of forced labor. Children would be planting seeds for corn and rice stocks.

In the provinces of Hamhaebuk-do and Hamkyungbuk-do, there are large-scale farms for growing opium. Students in nearby schools work on the fields to gather the opium extracts and to dry opium flowers and stocks. Those activities are carried out at the direction of their teachers and the state.

It is a well-known secret that hard currency collected from the sales of opium produced with forced labor from children, gold is mined and collected from slave labor in the Czechoslovakia, Russia, and counterfeit monies which is laundered by diplomats is deposited in the banks in Macau and Switzerland. The money is a slush fund for Kim Jong-Il's personal use, and we have heard of these things from diplomats and other escapees from North Korea.

Kim Jong-Il holds up that he has no money to buy corn for the starving people of North Korea. At the same time, he has money for catering to his personal needs. He has spent \$900 million worth of money to permanently conserve the deceased body of his father. He is spending astronomical amounts of money for his nuclear program. Yet he has no money for the people. Kim Jong-Il is no ordinary sinner that can be forgiven. He is the satan himself. He must not be forgiven.

Once Kim Jong-Il is expunged and a new democratic government is established in North Korea, the problems of human rights abuse and other criminal activities that have been plaguing the world community will all be yesterday's use. There are various means for achieving unconditional surrender from Kim Jong-Il. One of those would be to freeze his slush funds resident in the Switzerland bank accounts. I implore the U.S. Congress to investigate Kim Jong-Il's accounts in Switzerland and freeze those accounts.

I believe it is also possible to pressure Kim Jong-Il by acting quickly on the human rights acts which have been passed in the U.S. Congress already, and also allowing for safe passage of the North Korean escapees into third countries, including the United States.

Senator COBURN. I want to limit your testimony. We have gone 12 minutes now, and to be fair to our other witnesses, we need to limit this, so I will give you 30 seconds to sum up.

Mr. KIM. [through interpreter] In concluding, I would like to thank the people of the United States for taking an interest in the

issues surrounding the North Korean people and also the Congress of the U.S. and also Ms. Suzanne Scholte of Defense Forum. Thank you.

Senator COBURN. Thank you. Dr. Asher.

**TESTIMONY OF DAVID L. ASHER,<sup>1</sup> INSTITUTE FOR DEFENSE ANALYSIS**

Mr. ASHER. Mr. Chairman, thank you very much. Three years ago, Assistant Secretary Kelly and Deputy Secretary Armitage asked me to put together an initiative to counter North Korean illicit activities. The decision was born out of a comprehensive review of the North Korean economy that had been conducted over the previous year, a project that had identified an alarming build-up in transnational criminal dealings by the DPRK in the previous decade.

In March 2003, the State Department requested the Department of Justice to look into the issue of North Korean criminal violations of U.S. law. The DOJ appointed a highly capable senior prosecutor, Suzanne Hayden, who was charged with pursuing the evidence trail wherever it might lead.

In April 2003, we launched an interagency effort under the auspice of the East Asia Principals Coordinating Committee. This became known as the Illicit Activities Initiative (IAI). To oversee the IAI and to provide policy support for the Six Party Talks, in the summer of 2003, the Department established what was called the North Korea Working Group under the Office of the Deputy Secretary. I was appointed as Special Coordinator, and William Newcomb, a senior Asia analyst in our intelligence bureau, was made my deputy. We operated out of the seventh floor and had the full authority of the State Department to represent it at meetings related to our work in the NSC, which eventually itself formed a special coordinating committee that I co-chaired.

I want to underline that the Illicit Activities Initiative was never designed as a substitute for diplomacy. Assistant Secretary Kelly and I considered our work in the Six Party Talks, in which I participated as the delegation advisor, to be of paramount importance. We felt that the United States needed a strong two-track policy with both tracks directed toward creating the grounds for a normalized relationship with the DPRK.

On track one, we needed an empowered negotiator equipped with a broad series of transformational incentives that could spur the denuclearization process forward in concert with the other parties. On track two, we needed a process that would hold the North Koreans to a normal standard of behavior in the international community by enforcing our laws, by also guarding our flank more effectively against the growing threat of weapons proliferation.

The IAI, as you noted, sir, eventually came to involve 14 different government agencies and departments as well as over 100 policy officials, intelligence analysts, and enforcement officers. We had superb interagency cooperation and strong support from our leadership all the way up to President Bush, who I was pleased to

<sup>1</sup>The prepared statement of Mr. Asher appears in the Appendix on page 57.

serve. This was a major team effort. Although I may have been the quarterback, the coaches and players deserve most of the credit.

Between the spring of 2003 and the summer of 2005, we briefed and enlisted the cooperation of around 15 different governments and international organizations. I have to say, we enjoyed extremely strong support internationally. We developed a range of sophisticated policy options and plans, including the careful use of the USA PATRIOT Act and other tools that cut off North Korea's access to its networks of illicit banking partners internationally.

We instigated and coordinated the interdiction of contraband and helped to shut down front companies' illicit trading networks around the world. We also worked assiduously to provide support to our U.S. law enforcement brethren, some of whom are here today.

As noted before, the IAI spawned a series of large-scale U.S. and international criminal investigations. These involved U.S. Secret Service, Federal Bureau of Investigations, DEA, ICE, ATF, and many other foreign partners working in tremendous teamwork. Results of these investigations, for the most part, have yet to see the light of day, but I am confident when they emerge, the allegations of state-led North Korean criminal activity will be more than fully borne out.

Let me close with a review of implications for U.S. policy. First, law enforcement efforts and diplomatic outreach under the illicit activities need to be continued vigorously. Strong interagency coordination, calibration, and most importantly, leadership, are essential. Management structures for coordination need to be centralized, not dispersed, and those in charge need to be sufficiently highly placed and properly empowered to do their jobs effectively.

Second, we all need to better guard our flanks against the DPRK proliferation threat, especially at a time when we are cracking down on their illicit activities and finances. I recommended on previous occasions we need to take more aggressive protective measures, including enhancing the Proliferation Security Initiative and expanding the Container Security Initiative to inspect North Korean containers being exported abroad to our partner relationships in countries such as China and the Republic of Korea (ROK).

As I suggest in my prepared remarks, the threat of DPRK cooperation with Iran on nuclear weapons and missiles has to be taken extremely seriously, and especially at a time when both feel to a degree under seige, quite justifiably. In my mind, the United States has to take prudent measures against these major threats to our national security, but we need to understand that the more that we do, the more incentive they will have to collaborate.

Third, law enforcement and counterproliferation are not antithetical to a diplomatic strategy. To the extent that the North Koreans can sup on a moonshine economy, they will have very little interest, I believe, in sunshine engagement, a process which I support.

Fourth, change needs to begin in Pyongyang much more than Washington. It is in North Korea's objective interest to shift directions. As Secretary Powell used to tell us, they cannot eat nukes. The DPRK needs to engage what it calls on us to do, a bold switch-over away from nukes, crime, and repression as the pillars of the regime buttressed by a bankrupt concept of self-reliance, "Juche,"

and an army-first state policy that is draining the economy dry. Instead, like China in the late 1970s and Vietnam in the late 1980s, at the very least, North Korea must turn toward denuclearization, demobilization of the army, and economic and gradual political opening. As part of this, they most certainly have to abandon their criminal activities and repression of their populace.

Fifth and finally, the members of the Six Party Talks—America included—need to offer help to North Korea for it to transform. I don't think we can be naive about the scale of transformation that is required in North Korea nor of the disruption to the surrounding states, the world, if North Korea were just to collapse spontaneously. I certainly do not support this regime in North Korea, but I think we have to be realistic about the implications of an aggressive regime change policy that some suggest.

It is in North Korea's interest to open up and it is in our interest to help them, provided they are willing to play by international rules. As Secretary Rice has said, it is North Korea's choice to be isolated. If they stop engaging in hostile acts and start cooperating, they will reap the benefits of engagement.

I am happy to answer any questions that you or any other Subcommittee Member have.

Senator COBURN. Thank you, Dr. Asher. Mr. Downs.

**TESTIMONY OF CHUCK DOWNS,<sup>1</sup> AUTHOR, "OVER THE LINE:  
NORTH KOREA'S NEGOTIATING STRATEGY"**

Mr. DOWNS. Thank you very much, Mr. Chairman. I would like to thank the Subcommittee for inviting me to speak today and for its attention to this very important issue. I speak as a private citizen and author of a book on 50 years of how North Korea negotiated, not in my capacity as a member of the Board of the U.S. Committee for Human Rights in North Korea, of whose work I am extremely proud.

As other witnesses have said, North Korea is a criminal state, but it is more than that. It is actually an extra-legal state. It does not even abide by its own laws. Under the constitution of North Korea, the presidential authority is actually vested in a dead man, and this is the constitution that was put in place 4 years after Kim Il-Sung died. Kim Jong-Il, who actually rules North Korea, rules from a position as deputy of the National Defense Commission, a ruse that gives him the opportunity to say he is not really in charge even though everyone knows that he is.

Kim Jong-Il punishes those he finds threatening in mock judicial proceedings that defy North Korea's own laws. He orders executions in public that children are forced to attend, in defiance of international standards of human rights. And he incarcerates thousands of political prisoners, as we have heard Kim Seong Min say, in a gulag that he claims does not exist.

It should not be surprising to us that a Nation that subverts its own laws also defies its international obligations, but I would like to focus on the questions that you and Ranking Member Carper, Senator Carper, asked about the effect of American enforcement ac-

<sup>1</sup> The prepared statement of Mr. Downs appears in the Appendix on page 69.

tivities on the talks that deal with important issues such as the nuclear issue.

First, a word about how North Korea negotiates based on my research. North Korea understands that it has very little to bring to the negotiating table. Its economy is always in a shambles. It has very little in terms of natural resources. It has very little to offer the rest of the world. It believes that it can only gain power and attention by making threats and by creating aggravation. And it has learned over 50 years of negotiating experience that this approach actually works for them.

They create crises that make other nations want to bring North Korea to the negotiating table. North Korea's own negotiating objectives are never to enter into an agreement. They are actually to avoid agreements, draw out the negotiations as long as possible to draw down the other side's negotiators and to win concessions during this tiring process. They like to demand concessions while yielding nothing in return, which may seem obvious for every country, but it really isn't. They like to get benefits. In fact, they demand benefits just for agreeing to attend negotiating sessions. And they like to block progress at the talks because they know that if they extend this, they have more opportunities to gain leverage.

And when they are finally forced to sign onto agreements, they like to make sure that there are provisions in those agreements that make them unenforceable. Implementation is always deferred to some organization that has to be set up by mutual consent and they withhold their consent later on. This happened with very promising agreements in 1991 and 1992.

But North Korea does benefit during this process of avoiding negotiations. What it means is that they have a topsy-turvy approach to what we see as an attempt to actually get work done.

So how can we deal with this, and I would suggest in response to the questions that you asked and the questions that Senator Carper asked about the impact of the enforcement activities on the negotiations that the enforcement activities are actually a better means of getting what we want done with North Korea, and specifically on the negotiations, taking adverse action against North Korea's and specifically Kim Jong-Il's financial interests, we have produced the following benefits.

We have advanced multilateral unity. No country—not China, not South Korea, not Japan, certainly—is interested in being seen as an advocate of counterfeiting. If you call North Korea to task for these activities, other nations will side with you. As Mr. Asher just said, we have had extremely strong support internationally on these efforts.

Taking these actions like the Section 311 designation also gives North Korea the impression that its own leverage gained by making threats and creating these crises diminishes, and whether for the near term or the long term, they begin to feel uncomfortable with the strategy that Kim Jong-Il, who they see as a genius, has taken. It chastens the regime for its behavior and makes it act, at least temporarily, somewhat compliant, and it sends North Korea, these enforcement activities, a signal of American resolve that Kim Jong-Il, who rules by coercion, can understand.



It can't help but make North Korea wonder whether—particularly the ruling party—it can't help but make the inner circles of the very nervous ruling group wonder if Kim Jong-Il is the genius that they say he is. It gives them a little bit of information of what Kim Jong-Il does on the international scene. And when you are talking about, if I can use the term gravy train, when you are talking about benefits that are gained illegally, there are always other people who wonder if they aren't being cut out of the gravy train, if they are not somehow being disadvantaged.

And even in a closed society like North Korea, if you task diplomats with trying to explain and defend North Korea's counterfeiting activity, some of those diplomats will get the word around and in the ruling circles in Pyongyang, people will begin to wonder about whether Kim Jong-Il is doing what he should be doing and whether his strategy is a good one. They will begin to feel insecure and this could have a very important impact on our dealings with the regime.

So let me conclude. I know that there are other people who have very important things to say and I certainly want to give Kim Seong Min, who is a very heroic center of the defectors' efforts in South Korea today, more of a chance to talk, but let me just conclude that confronting North Korea on their lucrative illegal activities holds far more benefits than losses for regional security and international peace. And, in fact, it enhances the allied posture in the process of negotiation. Thank you.

Senator COBURN. Thank you. Dr. Noland.

**TESTIMONY OF MARCUS NOLAND,<sup>1</sup> SENIOR FELLOW,  
INSTITUTE FOR INTERNATIONAL ECONOMICS**

Mr. NOLAND. Chairman Coburn, Ranking Minority Member Carper, it is an honor to be here this afternoon. I feel as though we have reached that moment in the afternoon in which nearly everything has been said, just not said by me. So rather than repeat what previous witnesses have said, in some cases far more definitively than I could, I would like to emphasize a few points that may not have received appropriate attention.

First of all, the first one involves the role of illicit activities and state culpability. To understand North Korea today, you really have to go back 10 or 15 years to the famine period of the 1990s. Under the trauma of the famine, in some essential ways, the state failed and what came out of that state failure were two things. One was a bottom-up process of marketization of the economy and the second one was a loss of central control over the economic and political institutions of the country.

Now, the relevance to that for our discussion today is that one can interpret in part the intensification of emphasis on illicit activities as a response to that economic failure, and at the same time, it suggests that while it is clear that the state is involved in these activities, the pervasive nature of the state within North Korea—virtually every economic asset is owned by the state in some form, most everyone works for the state in some way—means that—and combined with the decentralization that has occurred, that some of

<sup>1</sup> The prepared statement of Mr. Noland appears in the Appendix on page 75.

these activities may not be centrally directed, that they may reflect essentially decentralized gangsterish behavior.

The second issue has to do with the role of U.S. policy. As we have heard from previous witnesses, U.S. attempts to impede this activity have met with some success. They have also negatively impacted legitimate commerce, as well. Basically, what has happened this spring in response to the financial pressures has been essentially financial disintermediation. Foreign financial institutions no longer want to deal with DPRK institutions. And some people who are doing legitimate business in North Korea are finding it more difficult to do so.

Now, how one evaluates that depends on what one's goal is. If the goal is simply law enforcement, as we heard from the first panel, then impeding the illicit activities is good and the collateral damage on legitimate commerce is unfortunate. If the goal is to achieve diplomatic goals in the context of Six Party Talks, as Senator Carper raised, then one's response is ambiguous. It probably is going to require both carrots and sticks to achieve those goals, and so in that sense, one is not so worried about the negative impact on North Korea.

But if one has a more ambitious goal of achieving regime change through some sort of financial pressure, then I think that this policy is unlikely to succeed, basically because China and South Korea fear instability far more than they fear the status quo and they would move to offset U.S. pressures.

The third point addresses the labor issues that Senator Coburn raised in his remarks and in some questions, and here, I think there is potentially a specific Congressional legislative point of action rather than the broader oversight issues that we have been talking about today, and that could come up in the context of the free trade negotiations between the United States and South Korea that are scheduled to begin in June and the role of the Kaesong Industrial Complex in those negotiations.

The Kaesong Industrial Complex is an industrial complex in North Korea established essentially by the South Korean Government, and in previous free trade negotiations, the South Korean Government has requested its partners to grant duty-free status to the products produced in Kaesong. Now, this immediately raises labor issues with respect to the United States. There will surely be a labor standard chapter in the FTA agreement, assuming that an agreement is reached, and including Kaesong in that agreement would raise two sorts of issues. The first is substantive and the second is procedural.

Substantively, North Korea does not meet any core labor standards. The right to organize or associate to bargain collectively are absent entirely. The workers in Kaesong earn \$57.50 a month as base pay for a 48-hour week, but the North Korean Government takes money out of that to pay for various things and so at the end of the day, the workers get about a dollar a day. But that dollar is translated into their wages at the official exchange rate into North Korean won, which is completely fictitious. If you use the black market exchange rate, which is a more realistic measure of what the North Korean won is really worth, those workers are making maybe \$2 to \$3 a month. And the real problem which I

want to underscore with North Korea is that as exploitative as those terms might be, they are probably much better than other jobs in North Korea or in the labor camps that you mentioned. As a consequence, there may be no shortage of workers willing to take those jobs.

The second issue is procedural. South Korea has no way to enforce any commitments in a FTA agreement in Kaesong where North Korea is sovereign. Jay Lefkowitz, President Bush's Special Assistant for Human Rights in North Korea, has suggested involving a third party, such as the International Labor Organization, to monitor conditions, as was done in the Cambodian textiles case. The problem, of course, is that North Korea is not a member of the ILO and may not agree to that, and indeed, even this relatively minimal sort of proposal was recently criticized in some fairly in-temperate terms by a spokesman for the South Korean Ministry of Unification.

In conclusion, the controversy over Kaesong as well as some of the illicit activities that we have discussed this afternoon bring us back to, in some ways, the famine experience of 10 years ago and raises the practical and ethical issues that outsiders have in dealing with North Korea in a situation where the North Korean people are completely victimized by a government over which they have no real control, and the problem of trying to do right by the North Korean people in a context in which some other major countries do not share our priorities in dealing with this country whose values are in very large part antithetical to our own.

It has been an honor to be invited here and I would be happy to take any of your questions. Thank you.

Senator COBURN. Thank you very much.

Mr. Kim, are there any reliable reports from recent defectors that would substantiate a continued large number of hectares in poppy production?

Mr. KIM. [through interpreter] We have escapees from the provinces of Hamkyungbuk-do and Hamhaebuk-do who are testifying that as of recent, there still are these fields containing opiums. Also, we hear from people that youngsters are forced into labor to collect the extracts from these opiums.

Senator COBURN. What I am trying to get a handle on is are there any reports as to the actual number of hectares? In other words, the report is less than 100 hectares of poppy production, and yet if that is the case, then there would be a limited production for domestic use only. If it is above that, then there would have to be a question raised if, in fact, this is for illicit production. Can you give us an estimate of what people have told you about the size in terms of acreage or hectares of that production?

Mr. KIM. [through interpreter] In the province of Hamkyungbuk-do, there is an area, a county called Yun-San Kun, and also in the area of Hamhaebuk-do, there are two counties called Bu-Pyung Kun and Chang-Jim Kun, and my understanding is that 70 percent of all fields that could be cultivated are being used for production of poppy seeds. As to the actual hectares, this would be, in Korean scale, 300,000 jung-bo—correction, 30,000 jung-bo in Korean terms.

Senator COBURN. Can you relate that to hectares?

Mr. KIM. [through interpreter] That also equals to about 30,000 hectares.

Senator COBURN. OK. So a significant difference in what we can ascertain versus what we are hearing.

Mr. Kim, one other question for you. Can you respond to Dr. Noland's suggestion that some of the activities that we may be seeing are decentralized, in other words, are part of non-directed, non-controlled government behavior outside of Kim Jong-Il's control?

Mr. KIM. [through interpreter] As to your earlier question, sir, I only know of those three different counties, and as to the exact numbers, I will assure you that I will get back to the Subcommittee with the correct numbers.

And as to your second question, it is true that the central command has weakened quite a bit. We have seen that the people of North Korea are witnessing their neighbors dying right in front of their eyes, and just for their own survival, they are having to break the laws, and when they are breaking the laws to survive, it becomes hard for the central government to place more control on these people. It is also true at the same time, however, that the central government is trying to hang on to their control as much as possible.

So what has increased in the recent years, as we have witnessed on the first day of March and second day of March of this year, there are more public executions that are taking place by firing squads.

Senator COBURN. One last question, and this I am asking for your opinion. Is it your feeling that the government of South Korea makes it somewhat difficult for North Korean defectors to go public with their eyewitness accounts of atrocities committed by the Kim Jong-Il regime?

Mr. KIM. [through interpreter] There is no public mandate from the South Korean Government that stops us from talking about or discussing the occurrences in North Korea. However, there seems to be a tacit agreement between the South Korean Government and Kim Jong-Il that there is some sort of a conciliation between the two regimes and that the South Korean Government makes it known that it is not happy when we do talk about North Korea in negative manners.

However, the escapees whom I know and my comrades who I am working with, we are not afraid of these pressures coming from the government and we do our very best and we put our lives on it as we work towards a peaceful unification of the Korean peninsula.

Senator COBURN. Thank you. Dr. Asher and Mr. Downs, after we have seen numbers of North Korean diplomats, well, not arrested, but interdicted and sent home, in your opinion, what is it going to take for us to bring an indictment against the North Korean Government for this illicit behavior? And will that hurt or help U.S. negotiations?

Mr. ASHER. This is something that we, of course, people have discussed. The Secret Service, the Department of Justice and the Secret Service investigation has indicted the North Korean Government, in effect, for counterfeiting the U.S. dollar. One could imagine that the leadership ultimately could be held accountable. But we also need to consider the fact that indicting the leadership of

a foreign government, a government that we are committed to a diplomatic process with, would not be particularly constructive, obviously.

We were able to work with Qaddafi and able to transform a relationship that seemed in sort of a pitiful and abjectly backward state. I think there is some precedent from that case that could be applied to North Korea. But we also have to approach North Korea open-minded and realistically. This is a government that has been correctly described as a criminal state. Some joke of it as sort of a "Soprano" state.

We have to, I think, apply law enforcement pressure aggressively against the networks which are distributing contraband being produced in North Korea. The perpetrators, ultimate perpetrators of those crimes, of whom I am confident the North Korean leadership is tied into, need to understand that they should be under notice, and to the extent that they don't stop in a reasonable period of time, I think we have to consider more extraordinary measures. But we also need to understand that to take unilateral actions without the full support of the Chinese and the ROK, and indeed Russia and Japan, would not be particularly constructive.

We have had success in unilateral financial actions, which have definitely crimped the ability of the North Koreans to illegally distribute merchandise, such as counterfeit cigarettes, counterfeit currency. I even brought some for you, not that anyone really needs to see it, but it is amazing, the quality of counterfeit cigarettes being produced in North Korea. Counterfeit Viagra is a major market.

These items are providing income that goes right to the top. So mere law enforcement actions conducted effectively can have a significant impact on the bearing of the leadership and their attitudes. Again, as I said in my testimony, to the extent they cannot rely on moonshine, on economic moonshine, for their existence—and I should note that this money, again, goes to the top, they rely on it, it doesn't go to the people of North Korea, so it is a very targeted approach—their incentive to take sunshine seriously, engagement seriously, will certainly increase over time.

Senator COBURN. So let me ask you a follow-up question. Are we continuing a very aggressive two-track strategy, in your opinion?

Mr. ASHER. Yes, I think we are continuing it. It perhaps is being approached with less centralized coordination than we had during my time.

Senator COBURN. Why would that be?

Mr. ASHER. Well, I think it is strictly the way that the management of the Department, who I applaud, I am a tremendous fan of Secretary Rice and Assistant Secretary Hill, but they want to work this much more through standard operating procedures and bodies like the Korea Desk, which is full of some very outstanding diplomats, rather than having specially appointed people like myself, whose job was more or less to ride herd on the North Korean—

Senator COBURN. Is there loss of coordination with that movement?

Mr. ASHER. I don't think there is a loss of coordination. It may be a loss of spit and vinegar determination. It is hard to be in charge of the Six Party Talks at the same time you are going after

their bad side, undoubtedly. I was involved in the Six Party Talks intermittently, but that was as an advisor and as a planner, basically trying to come up with means of how we could get them out of these sorts of businesses and out of repression of other people toward something better as other Communist States which have transformed have shown to be possible. I don't think the North Koreans necessarily believe that, but it is our responsibility at the State Department to at least be prepared for that.

At the same time, most of our time, we were devoted with a large degree of interagency support, literally well over 100 people, you could say hundreds of people involved in pursuing their activities globally, and I am very proud to see that work continues.

Senator COBURN. Mr. Downs, any comments?

Mr. DOWNS. I don't have much that I would want to add to that except a point that may actually be overly obvious. When the U.S. Government takes action like the Section 311 designation, there is immediately one bank, and maybe more, that is not providing what it used to provide to the regime to help the regime carry out its illegal activities. It also has a multiplier effect because other banks see what has happened to that one bank. In this case, it was Banco Delta Asia. They see what happened when the United States makes a determination like that on that bank's business, legitimate business, and they don't want to be in the same position, so they stop the funding flow for North Korea's activities.

Eventually, much of what the regime does gets back to this illicit funding flow. They have to have, according to Nick Eberstadt's estimate, at least \$1.2 billion that they cannot generate domestically in order to satisfy the elites, in order to keep the Mercedes running in the hands of the generals in Pyongyang.

If you begin to cut back on these things, you are also cutting back on the faith they have in Kim Jong-Il. So the long-term impact of these kinds of activities can be very real and very constructive. That cannot be said for the negotiating process.

Senator COBURN. Dr. Noland, you presented a very concise picture of kind of where we stand and the delicacy of collapse and what that might mean, and also the other interested parties, especially their two neighbors, in why they would not want anything to come near that. My question is, how do we continue this process and still be available to offer humanitarian aid to so many people out there who need it? Is there a way that we can do that without showing weakness and still offer a humanitarian hand that won't complicate the Six Party Talks, that won't complicate our interdiction, and at the same time help supply basic foodstuffs and necessities of life to those people who are the subject of this dictator?

Mr. NOLAND. Historically, the United States has pursued a policy in which we, at least rhetorically, separate humanitarian aid and broader foreign policy concerns, though in reality we often mix the two.

In the case of the humanitarian aid, the U.S. Government, I believe, particularly under the Bush Administration, which I have often criticized on other grounds, I think has done a very good job of attempting to deliver humanitarian aid in a way that is most effective in actually getting aid to the people who need it and has been a very strong supporter of that process multilaterally.

Specifically what I mean, it basically has to do with three things. We know that geographically, the incidence of need is not uniform across North Korea either socially or geographically, and what the U.S. Government and U.S. AID has done is push the World Food Program, which is the major multilateral conduit of that aid, to provide the aid in forms that are not liked by the elite. So instead of rice, provide corn, barley, millet, things of that sort, and then push that food aid into the northeastern part of the country, which is the worst affected area, where the greatest need is. So send that into ports like Chongjin. I think that has been very effective.

The second thing that the United States has supported, though less effectively, is to have a strong monitoring system. We have a situation which at its peak was well below the WFP program, was well below international standards. We had a situation in which the North Koreans did not allow Korean speakers, for example, to participate in that monitoring process, in which visits to these institutions that were being supported required pre-notification. And we only had 50 monitors trying to monitor an area roughly as big as New York State or Louisiana.

What we have seen in the last 6 months is a retrenchment that was alluded to by another one of the witnesses. The North Koreans have banned the trade in grain, private trade in grain, and have essentially tried to force people to go back to the old centrally planned and state-run public distribution system. At the same time, it has demanded that both the private NGOs and initially the World Food Program leave the country.

My understanding is that in March, the Executive Board of the World Food Program approved a program that would greatly reduce both the volume of aid, but it would extremely reduce the quality of monitoring. The five regional sub-offices around the country would be shut down. There would be less than 10 people in the program, all in Pyongyang and only allowed to leave the city of Pyongyang once every 3 months. That process has been supported by better than expected harvests for the North Koreans this past fall as well as large, relatively unconditioned aid flows from China and South Korea.

The problem, of course, is that the North Koreans are playing a very reckless game with people's welfare and the situation they have set up—seizures of grain in the rural areas, banning private trade in grain, which was the mechanism by which most people got their food—sets up the possibility that the situation internally may worsen significantly later in the year, and indeed, there are already reports that the revived PDS is failing even in the city of Pyongyang.

Senator COBURN. I have one final question, and I want to state that I am a great supporter of Secretary Rice. I think she is doing a phenomenal job for us. But I still am at a little bit of a loss to think that we have lost some of this coordinated two-track effort, and I am going to ask our panelists if they think if we had a—and I know we have a North Korean Desk and I know we have somebody for East Asia policy—but would it be to our benefit to re-institute what we had or have a czar that covers this area, that coordinates both the Six Party Talks, coordinates humanitarian relief, and also coordinates our interdiction, that one person, one re-

sponsible, one person that can be looked down the line, this is the person that is doing all that? Any comments on that?

Mr. ASHER. Well, I mean, most certainly, that was the goal of the Office of the North Korea Working Group Coordinator that I had reporting directly to the Deputy Secretary, and it was housed on the seventh floor, so it was very clear to people who was behind us.

I think that, frankly, at least as far as proliferation illicit activities go, sort of the dark side of North Korea, it makes sense to have one person tasked to coordinate an interagency effort. I also think—and my colleagues know this—that there is an unnecessary, not certainly helpful bifurcation between the Illicit Activities Initiative and the Proliferation Security Initiative as it is applied to North Korea. Perhaps for that reason, we have had some failures on the proliferation front, not that we were aware of them at the time, but there are some things that we could do better, undoubtedly. I think that there is an effort to do better at this time.

But as I said, the relationship between the DPRK and Iran is undoubtedly evolving quite precipitously. The shipment of the BM-25 missile, which is the most powerful missile ever exported to another country, as far as I know, by the North Koreans apparently to the Iranians in the couple years has potentially very destabilizing impact on our European allies, on Israel, and ultimately on U.S. security interests. One, frankly, wonders why the Iranians would procure such a missile if they didn't have something to go inside it. Our official view, of course, as a government is that there isn't, a weapons program is far away in Iran, and I have no reason to doubt that. But it is interesting and somewhat curious.

I think the more that we can centralize both the diplomatic efforts and empower the diplomats and empower the people who are engaged in policing the North Koreans, in effect, around the world, the more effective a basis for a policy, a sort of sunshine and the stick. The two can go together. I don't disagree with Mr. Downs that there is, despite the obvious upset of the North Koreans at being called out for counterfeiting the U.S. dollar, a Casus Belli Act under international law, an act of economic war—which we have not treated that way but undoubtedly could be classed that way—is indicative, frankly, of the extent to which the North Korean leadership has come to rely on these activities.

They just have to stop, and if we have to force them to stop, well, that is fine. But at the same time, we have to open up a line of communication to them and our negotiator has to be empowered. Thank you.

Senator COBURN. I just would make note that in relationship to Iran, we have Nicholas Burns who is a face and a name that handles all that. Again, I would just say, North Korea does not in terms of our State Department.

I want to thank each of you for being here. We will leave the record open if you have additional things. We will have some additional questions for you. Your interest, knowledge, and effort to attend the Subcommittee is very much appreciated. I want to thank you for your time and your testimony and God bless you.

The hearing is adjourned.

[Whereupon, at 4:15 p.m., the Subcommittee was adjourned.]



## A P P E N D I X

---

### PREPARED STATEMENT OF SENATOR LEVIN

Let me join the Chairman in welcoming our witnesses. I would also like to thank the Chairman for holding a hearing on North Korea.

For about 4 years a nuclear crisis has been building on the Korean peninsula. Regrettably, the Administration has been unable to manage this crisis. Indeed, it appears that over the last several years North Korea may have increased its nuclear weapons arsenal from one to two weapons to up to 12 nuclear weapons this year. The reactor the North Koreans restarted over a year ago continues to produce plutonium, and another reactor which had been under construction could produce 10-times more plutonium than the existing one.

Meanwhile, the six-party talks remain stalled over counterfeiting issues that the United States raised in the same month the last round of talks concluded. There is no diplomatic progress, and North Korea has not frozen its nuclear activities during the talks. North Korea continues to use the time to bolster its nuclear arsenal.

The Administration has relied on a six-party talk constructed at the expense of making progress. While the North Koreans said they wanted bilateral talks, the Administration refused to meet unless it was in a multilateral setting. So we now appear dependent on China and on continued cooperation among the four countries working with us to bring North Korea to the negotiating table. Yet, our relations with South Korea, are at a low mark in recent history, with the South Korean Government reportedly fearful that this Administration may advocate using direct punitive action to force regime change, rather than negotiations to settle the nuclear crisis. And just last week Japan and South Korea averted a confrontation over a cluster of islands in the Sea of Japan, or East Sea.

North Korea's illicit activities violate human rights, damage world trade, and undermine international financial systems. At the same time, we need to address these activities in a way that does not undermine our abiding national security interest in ensuring that nuclear weapons are eliminated from the Korean peninsula. I hope that our witnesses will give us their views on the relationship between the Administration's new policy on illicit activities and how to revive the program comes from illicit revenues? Will decreasing North Korea's illicit revenues make it more difficult for the country to support their nuclear program, or will they simply divert other income to the nuclear program? How can we clamp down on counterfeiting, money laundering, and other misconduct, while continuing to press for North Korea to eliminate its nuclear weapons and programs? I look forward to today's testimony.

### PREPARED STATEMENT OF SENATOR BROWNBACK

Mr. Chairman, thank you for calling this timely hearing during North Korea Freedom Week, an important event to shed light on the horrific suffering in North Korea. This week, many will gather in a variety of forums to hear refugees and defectors from the North tell their stories about life under one of the most repressive regimes in all of history. People from across the country and Asia will be here to stand up for the suffering people of North Korea.

Unfortunately, the state of affairs in North Korea is deteriorating further as the regime continues to misuse its resources and funnel profits from illegal activity toward malign ends. There are very few places in the world today that could compete with the level of corruption and terror imposed by this failed state.

On May 20, 2003, Senator Peter Fitzgerald sponsored a similar hearing to the one being held today titled, "Drugs, Counterfeiting, and Weapons Proliferation: The North Korea Connection." In that hearing, two North Korean defectors gave a de-

tailed account on how the regime has made the export of narcotics and missiles a state-run business. It is also no secret that North Korea is suffering from one of the worst human rights situations in the world today. One of the reasons for that is because the regime, under Kim Jong-Il, has been able to bolster support with financial backing via illegal activities.

All of the illicit activities North Korea have engaged in poses a threat not only to the people of North Korea, but also to the rest of the world. All of the evidence leads me to believe that the proceeds from counterfeiting are used to maintain the North Korean dictator's taste for luxury imports, the need to subsidize his inner circle of supporters, the production and sale of several missiles systems, and the expansion of North Korea's WMD programs. North Korea may even be favoring the cultivation of more drugs on land meant for agricultural purposes, despite the massive starvation that has overrun the destitute state.

I would like to commend the Bush Administration for aggressively taking steps to isolate the North Korean regime through the Proliferation Security Initiative and the Illicit Activities Initiative. By imposing sanctions on financial institutions involved in laundering North Korea's counterfeit currency and the proceeds from narcotics and arms trafficking, the U.S. is influencing the power of the North Korean state to continue its misguided policies.

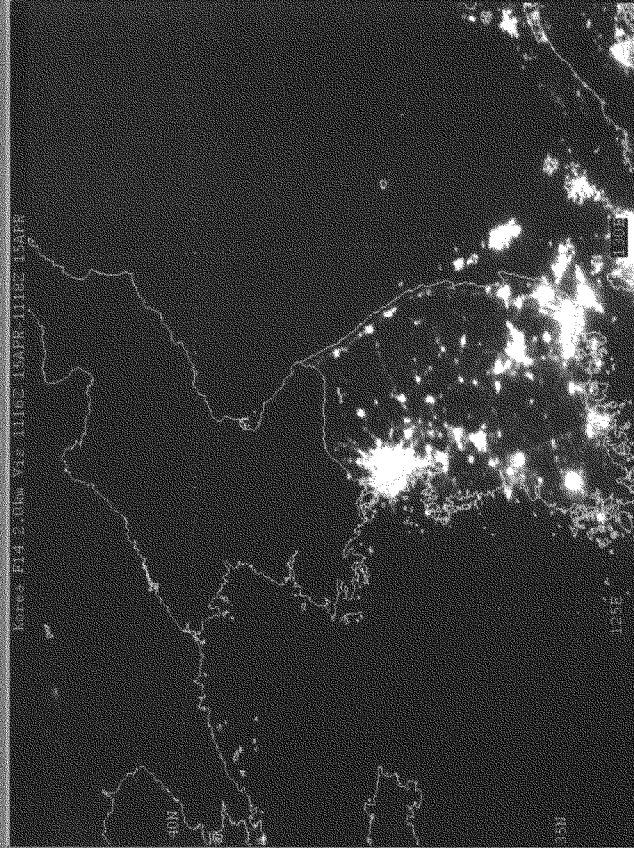
The depressing facts about the state of affairs in North Korea underscore the need for more hearings like this one, and again I commend the Chairman for convening this hearing. Let me conclude by noting that the real victims of North Korean regime's illicit activities are the people of North Korea. The North Korean regime's power is sustained because of its successful involvement in illegal activity. The U.S. and the international community should do everything it can to stop North Korea from profiting from drugs, weapons, trafficking, and counterfeiting. Only with sustained pressure will this evil regime be forced to face up to its obligations to international law and the basic human rights that its citizens deserve.

Thank you, Mr. Chairman.

## Uncovering Supernotes



## Satellite Image of the Korean Peninsula



Statement of

Peter A. Prahar, Director  
Office of Africa, Asia and Europe Programs  
Bureau for  
International Narcotics and Law Enforcement Affairs  
Department of State

Before the

Subcommittee on Federal Financial Management, Government Information,  
and International Security  
Senate Homeland Security and Government Affairs Committee

April 25, 2006

**North Korea: Illicit Activity Funding the Regime**

Mr. Chairman, Ranking Member Carper, and distinguished members of the Subcommittee: Thank you for the opportunity to appear before you today to discuss narcotics trafficking and other criminal activity with a connection to the Democratic People's Republic of (North) Korea -- the DPRK -- and what actions the Department of State is taking to address these activities.

**DPRK Narcotics Trafficking: Indications Of State Sponsorship**

First, let me discuss the subject of DPRK-linked narcotics trafficking.

Over a period of 30 years, officials of the Democratic People's Republic of Korea have been repeatedly apprehended for trafficking in narcotics and engaging in other criminal activity, such as passing counterfeit U.S. currency. Since 1976, there have been at least 50 arrests or drug seizures involving North Korean party and government officials in more than 20 countries around the world. The most recent public reports of specific incidents of narcotics trafficking with clear, demonstrable North Korean connections occurred in 2004, when DPRK diplomats were implicated in separate drug trafficking schemes in Egypt (Clonazipam

tablets, June 2004) and Turkey (Captagon tablets, December 2004). However, given developments during 2005 that linked the DPRK to other forms of state-directed criminality, the Department of State retains the view, as stated in the 2005 International Narcotics Control Strategy Report (INSCR), that it is “likely, but not certain,” that the North Korean government sponsors criminal activities, including narcotics production and trafficking, “as a way to earn foreign currency for the state and its leaders.”

The Department’s conclusion -- “likely, but not certain” -- is deliberately tentative. The DPRK is one of the most closed and secretive societies in the world. Our knowledge of drug trafficking and other DPRK-related criminality comes from police and press reports, defector statements, embassy and intelligence reporting of various governments and, in the case of trademark violations, the findings of trademark-holder investigations. Even in the case of high profile incidents of alleged drug trafficking, it is frequently impossible to get beyond an initial report, since foreign law enforcement officials are often unable to conduct full investigations in cases of illicit activities being conducted by officials enjoying diplomatic immunities and privileges. The suspects can only be expelled and returned to North Korea to an unknown fate.

Because the details of any single incident may be incomplete or unclear, we look at these patterns of activity to answer the question: What is the extent, if any, that criminal activity by North Koreans is state-directed?

In the case of North Korean drug trafficking and other criminality, we have found a pattern of activity over years. Foreign law enforcement cases have clearly established that North Korean diplomats, military officers, and other party and/or government officials have been involved in the smuggling of narcotics. Furthermore, they have established that state-owned assets, particularly ships and even military patrol vessels, have been used to facilitate and support international drug trafficking ventures. Examples of involvement of DPRK officials and state assets include calls at North Korean ports by traffickers' boats to pick up drugs, travel by traffickers to North Korea to discuss aspects of the trafficking operation, and suspected drug trafficking by North Korean patrol vessels. Reports of DPRK involvement in narcotics trafficking often occur within the context of reported incidents on a range of other criminal activities perpetrated by North Korean officials, including counterfeiting of U.S. currency, trademark violations involving cigarettes and pharmaceuticals, and trafficking in endangered species.

Due to the authoritarian, centralized nature of the DPRK state, it is difficult to imagine that the importation of the required precursor chemicals, the manufacture and shipment of illicit narcotics or counterfeit goods, and the subsequent export of the illicit products, sometimes in state-owned vessels including military patrol boats, could occur over many years without high-level Korean Workers' Party (KWP) and/or DPRK government involvement, if not state support and state sponsorship.

The quantity of information and quality of many reports give credence to allegations of DPRK state sponsorship of drug production and trafficking that cannot be ignored. The cumulative impact of those incidents over years points to the likelihood, but not the certainty, that the leadership of North Korea is behind this illicit activity.

#### **DPRK Narcotics Trafficking Patterns**

DPRK-linked drug trafficking has evolved over the years from individual DPRK officials apprehended for trafficking in narcotics in the 1970s and 1980s to the more recent indications of direct involvement of officials and vessels in providing drugs to Asia-based trafficking organizations for wider distribution in East Asia. The type of narcotics trafficked has changed as well, with methamphetamine and amphetamine-type stimulants increasingly associated with the DPRK.

From the mid-1970s to the present, there have been incidents involving North Korean officials -- diplomats and state enterprise employees -- apprehended in possession of narcotics (primarily opium and heroin) and other contraband in their possession. The number of incidents grew from a few in the 1970s and 1980s to many in the middle to late 1990s. Reported quantities of drugs involved were frequently quite small -- a kilogram or less. However, incidents involving larger quantities were also reported. For example, three DPRK diplomats were stopped with 174 kilograms of opium in Venezuela in 1977. Typically authorities seize the drugs, and the official North Koreans are declared persona non grata and returned to North Korea.

DPRK spokespersons continue to deny any state involvement in criminality, ascribe that criminality to individuals, and threaten punishment under DPRK laws. However, we have no information concerning the fate of the accused traffickers after their return to the DPRK.

Though the evidence is not conclusive, it is possible that North Korean diplomats and officials undertake illicit activities that are condoned or encouraged by the DPRK state in part in order to generate foreign exchange to help cover the costs of operating North Korea's missions abroad.

In the past decade, however, the DPRK narcotics trafficking link has appeared most significantly in connection with Asia-based criminal organizations that are trafficking and distributing methamphetamine and amphetamine-type stimulants, and possibly opiates, produced in North Korea itself. It appears that a symbiotic relationship has developed between the DPRK and these organized criminal organizations: Each side needs the other to profit. For the trafficking networks, the DPRK provides illicit items to sell; for the DPRK, the trafficking networks provide a useful "cutout" to put distance between the DPRK and its criminal enterprises. Organized criminal syndicates also provide the mechanisms for the DPRK to distribute its illicitly produced wares, including narcotics and counterfeit goods, in target markets like Japan. DPRK state trading companies frequently play a role in this relationship, with the DPRK having transformed itself into a "wholesaler" of illicit products.

East Asia is the largest market in the world for amphetamine-type stimulants, and Japan is the largest single market for methamphetamines in Asia. The Japanese National Police Agency estimates that there are 600,000 methamphetamine addicts and between one and three million "casual" users. Consumption is estimated between ten and twenty metric tons of methamphetamine per year.

Starting in the late 1990s, Japanese authorities disrupted a series of attempts by various Japanese Organized Crime Syndicates, also known as the Yakuza that were working closely with North Koreans to smuggle illicit stimulants into Japan. A review of several of these attempts involving ships give an indication of the nature and extent of the narcotics smuggling effort.

In April 1997, Japanese police seized 60 kilograms of methamphetamine at a small Japanese port and arrested three defendants. The methamphetamine had been shipped to an ethnic-Korean-owned trading company from Nampo, North Korea, aboard the freighter "Ji Song No. 2." Two of the suspects arrested in connection with the trafficking incident



proved to be ethnic Korean residents of Japan. Japanese authorities suspected they were members of a Yakuza gangster group.

In August 1998, Japanese Maritime Security Agency officials off Kochi Prefecture seized 200 kilograms of methamphetamine, which had been thrown into the sea, after surveillance of a Japanese fishing vessel. Another 100 kilograms from this shipment was lost. Two members of a Japanese Yakuza gang were arrested in the incident. Japanese authorities learned through their investigation that the drugs had been transported from the North Korean port of Hungnam, then loaded on the Japanese fishing vessel at sea. The North Korean vessel bringing the drugs to the rendezvous was a trawler-type vessel, a type of vessel used in the past for intrusions and intelligence gathering in Japanese waters by the North Koreans. Japanese officials suspect that this same vessel might have again been involved in narcotics smuggling when Japanese coastal defense forces sank the vessel in 2001. It was discovered by Japanese authorities that the primary mission of the North Korea vessel was to facilitate espionage activities in Japan. The secondary mission was to deliver methamphetamine to the Yakuza (Japanese Organized Crime Syndicate) the proceeds of which were to be used to fund further North Korean espionage activities in Japan. A cell phone was also recovered from the salvaged vessel with sixteen (16) calls made to phones subscribed by documented Yakuza. Further evidence of Yakuza involvement provided by the DEA indicates that three (3) separate Yakuza syndicates were investors in the procurement of 60 kilograms of methamphetamine for 100 million Japanese Yen (\$1 million U.S.). One syndicate brought 50 million Japanese Yen (\$500,000 U.S.) and the two other syndicates brought 25 million Japanese Yen (\$250,000) each to the area of pending insertion of North Korean spies.

In April 1999, Japanese law enforcement officials arrested 13 individuals and seized 100 kilograms of methamphetamine Japanese investigators believed to be North Korean in origin. The drugs were on board a Chinese flagged cargo vessel concealed in plastic bags containing clams for traditional Japanese soup.

On October 3, 1999, Japanese authorities made the single largest drug seizure in Japanese enforcement history, 565 kilograms of methamphetamine, with a street value in Japan of approximately U.S. \$347 million. One Japanese and eleven non-Japanese suspects (six from Hong Kong and five from Taiwan) were arrested in connection with the incident.

A subsequent investigation revealed that a Taiwan fishing boat had rendezvoused with a North Korean ship to take on the drugs. The Taiwan and Hong Kong suspects were members of known gangs (Triads) in both places, and had intended to move the drugs to the Tokyo area for sale to a Yakuza (Japanese organized crime) group.

On February 9, 2000, 250 kilograms of North Korean origin methamphetamine were seized in Shimane prefecture of Kyushu, Japan. The drugs loaded from a North Korean vessel aboard a 12.9-ton Japanese fishing vessel named the "Eifuku Maru" for transport to Japan. Police arrested four Japanese nationals, one with connections to a Japanese organized crime group. Following the seizure, police searched the premises of an ethnic- Korean-owned trading company to which the cover cargo of fish on the Eifuku Maru had been consigned. Japanese police suspect the owner of the firm of aiding North Koreans to smuggle drugs to Japan. The crew of the Eifuku Maru told police of an earlier success of a North Korea-origin drug smuggling run.

During the period 1997-2000, Japanese authorities also found suspected North Korean methamphetamine strapped to navigational buoys in their territorial waters. They assumed that it was awaiting pickup from accomplices among organized criminals on shore. Japanese enforcement authorities told the public that 43 percent of the methamphetamine seized in Japan during 1999 had some connection to North Korea. Thirty-seven (37) percent of the methamphetamine seized was based on intelligence received from the U.S. DEA. The Japanese reported to the 46<sup>th</sup> Session of the Commission on Narcotic Drugs in April 2003 that "since almost all [amphetamine-type stimulants] seized in Japan is trafficked through sea shipments, Japan is especially concerned by the sharp increase in [amphetamine-type stimulant] shipments from North Korea in the last five years."

Japan has not been the only Asian country to which North Korean-origin narcotics have been trafficked. In May of 1999, for example, Taiwan officials arrested four individuals, and seized 157 kilograms of amphetamine-type stimulants, believed to be North Korean in origin. Their subsequent investigation revealed that the drugs had been picked up in North Korea and then transported back to Taiwan aboard a Taiwan fishing vessel hired by the Taiwan drug traffickers.

In April 2003, the "Pong Su," an ocean going vessel owned by a North Korean State Enterprise controlled by the Korean Workers' Party, was seized off the coast of Australia. The Pong Su had brought at least 125 kilograms of very pure heroin to Australia. Four individuals charged in connection with the incident -- three ethnic Chinese criminals who formed the shore party receiving the drugs, and one individual from the Pong Su -- pleaded guilty to involvement with narcotics trafficking and are serving sentences of 17-21 years in Australia. The captain of the Pong Su, his first officer, the ship's navigator, and a "Political Secretary" (a member of ruling Korea Workers' Party), charged in connection with the heroin importation, were acquitted after trial in Australia. Australian authorities have since sunk the Pong Su, because it was seized while involved in criminal activity.

Since the Pong Su incident, only a few, relatively small incidents of narcotics smuggling with a North Korean connection have been reported. This is evidence, perhaps, that the criminal organizations have adapted to law enforcement successes in maritime seizures by switching to smuggling routes that cross the land border between North Korea and China and then moving illicit products to Asian markets. It may also indicate an actual decrease in this activity since 2003. At this time, we cannot state conclusively the reason for this trend.

A number of recent U.S. federal indictments linked together by either seizure of "supernote" counterfeit U.S. currency, or claims by individuals named in the indictments that they could procure "supernote," have been made public in the United States. "Supernotes" are associated with North Korea. About \$48 million worth of these notes have been detected or seized since 1989, many of them from North Korean diplomats. The crimes alleged in these indictments mostly took place in the period 2001-2004. While these indictments generally involved smuggling and trade in counterfeit, contraband (duty/taxes not-paid) cigarettes, some cases also involve narcotics and other controlled substances. Information from these indictments and their related, on-going investigations and prosecutions may eventually shed additional light on DPRK-related criminal activities.

### **Opium Poppy Cultivation And Heroin Production In North Korea**

There have been unconfirmed allegations that opium poppy is cultivated in the DPRK for illicit purposes. The Pong Su incident again raised this issue. However, it proved impossible to determine through

scientific means that the heroin came from North Korea, or to determine conclusively that it came from somewhere other than North Korea, like Southeast Asia.

North Korea has reported to the International Narcotics Control Board that a small amount of opium poppy -- under 100 hectares -- is grown in North Korea, but claims that the opium is refined for use in legitimate pharmaceutical products under strict controls.

However, North Korean defectors have told a different story, claiming that collective farms throughout North Korea are required to grow opium poppy and to deliver gum opium to state officials. Defectors have also claimed that the gum is then processed into heroin and trafficked in international markets under the direction of a government office (frequently identified as "Bureau 39" or "Office 39" of the Korean Workers' Party), presumably to raise hard currency for the state and/or the party.

For many years, based largely on these defector statements, South Korean authorities estimated that North Korea devoted from 4,200 hectares to 7,000 hectares of land to opium poppy cultivation, which produced from 30 metric tons to 44 metric tons of opium gum annually. Based on these estimates, the expected heroin production would be 3 to 4.5 metric tons, if all the opium went to heroin production. The Department of State used these estimates in the annual International Narcotics Control Strategy Report (INCSR) for several years. However, we eventually stopped including these estimates of opium/heroin production in the INCSR because the United States was unable to confirm these estimates in the way it is able to confirm illicit drug production estimates elsewhere, either through United Nations or U.S. Government ground or satellite surveys and statistical analysis.

### **Manufacture And Trade In Counterfeit Cigarettes**

Security and enforcement investigators for major American, British, and Japanese cigarette companies have conducted investigations into North Korean production of counterfeit cigarettes. The investigations concluded that at least one factory located in the DPRK manufactures and traffics in counterfeit cigarettes. There are reports of as many as twelve such factories, some of which appear to be owned and operated by North Korean military and security organizations, while others appear to pay the DPRK for a "safe haven" and access to transportation infrastructure to conduct their criminal

activities. These factories have the capacity to produce billions of packs of counterfeit cigarettes annually, some of which enter the U.S. market.

Counterfeit cigarette manufacture and trafficking are very profitable. Cigarettes made from low-grade tobacco can be produced cheaply and packaged in cartons made to mimic well-known brands, like “Marlboro®”. The cigarettes are then imported surreptitiously into markets where the cigarettes are taxed heavily. Counterfeit tax stamps are also produced, adding to profits by eliminating the need to pay taxes. Cigarettes, which cost the criminals very little to manufacture and ship, are then ready to be sold to witting and unwitting consumers for an excellent profit. The global scale of cigarette smuggling is large: billions of counterfeit cigarettes are sold illegally in the United States and abroad. One cigarette company estimates that the U.S. federal government and state governments lose about \$736,000 (weighted average) in revenue for each 40-foot shipping container of illicit cigarettes entering the United States.

Trade in counterfeit cigarettes avoiding duty and taxes is a significant criminal activity in Asia as well. With millions of smokers, high taxes, and duties on cigarettes in almost all jurisdictions and a preference for well-known foreign brands like “Marlboro®” and the Japanese brand, “Mild Seven” have attracted many organized crime organizations to cigarette smuggling. One of the earliest indications that North Korea might be involved in cigarette smuggling was reported in 1995: the seizure in Taiwan of twenty 40-foot shipping containers bound for North Korea filled with counterfeit wrappers for a major Japanese cigarette brand.

With its hundreds of millions of smokers, China had been a major source and market for counterfeit cigarettes. However, according to cigarette company investigators, beginning in 2002, China closed many factories manufacturing counterfeit cigarettes. Some of the manufacturing equipment and Chinese technicians relocated to North Korea to continue the illicit cigarette production free from the threat of legal action.

The quality and quantity of the counterfeit cigarettes produced in North Korea are evidence that a substantial investment has been made in equipment – an investment that would not be made if the owners were not assured that their investment would be immune from disruption and seizure by the authorities. The quality of the packaging (including print quality, embossing and the use of machines to apply glue to the boxes) in DPRK-

manufactured counterfeit cigarettes is higher than Chinese-origin counterfeits, where most packaging is done by hand and the threat of disruption by law enforcement authorities limits investment in sophisticated equipment.

When U.S. cigarette manufacturers became aware of the illicit trade in their firms' cigarette brand coming from the North Korean Export Processing Zone at the Port of Najin (also spelled Rajin), they began an investigation. During the course of the investigation corporate trademark investigators purchased counterfeit cigarettes, which they understood to be manufactured at a factory in Najin, examined the markings on the counterfeit packages and compared those markings to certain characteristic markings on legitimate packages. With this information and other clues garnered during their investigation of cigarette counterfeiting, the corporate investigators believe they can reasonably identify DPRK-source counterfeit cigarettes when they are located on the market.

From 2002 through September 2005, DPRK-sourced counterfeit Marlboro© cigarettes were identified in 1,300 incidents in the United States. The counterfeit cigarettes turned up largely on the West and East Coast of the United States, but some were also found in Texas, Arizona, Michigan, and Wisconsin, as well as in other states. Recently filed Federal indictments allege that for several years criminal gangs have arranged for one 40-foot container of DPRK-sourced counterfeit cigarettes per month to enter the United States for illicit sale over several years. The U.S. Government is seeking \$5 million in criminal forfeitures in several of these indictments. Reliable reports from other trademark investigators working abroad have placed DPRK counterfeits of Marlboros© and other brands in many countries, including Japan, the Philippines and Singapore.

In addition to revealing the DPRK as the source of these counterfeit cigarettes, these investigations gave an insight into the special relationships between DPRK officials and ethnic Chinese organized criminals operating in Asia, confirming a trend seen in law enforcement and other reporting. During the course of these undercover operations, the investigators dealt with ethnic Chinese criminal intermediaries who obtained counterfeit cigarettes from the Najin factory. These same Chinese criminal intermediaries offered their undercover contacts other illicit items, including counterfeit "supernotes" and counterfeit pharmaceuticals.

It is likely that the relationship between criminal elements in the DPRK and organized ethnic Chinese criminals operating in the region could facilitate the flow of narcotics and other contraband across the Chinese-DPRK border. Furthermore, industry investigators have identified a vessel named the "Chu Xing," which makes regular ferry-like trips between Chinese ports near Najin, at Najin proper -- where DPRK counterfeit cigarettes are manufactured -- and Pusan, South Korea. There have also been several seizures of methamphetamine in Pusan in containers loaded on this vessel in China. As these containers subsequently transited Najin, it is quite possible that narcotics cases in which the drugs are thought to originate in China represent, in fact, cases where the drugs originated in the DPRK and were introduced into the cargo in Najin.

#### **Other DPRK-Linked Criminality: CITES Trafficking**

There are about a dozen or so credible press reports linking DPRK officials with trafficking in ivory, rhinoceros horn, and other items listed in the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES). CITES is an international agreement aimed at ensuring that international trade in specimens of wild animals and plants does not threaten their survival. Although the DPRK is not a party to the CITES, its diplomats have been involved in trafficking in endangered species between party states.

Known DPRK-related CITES violations began in the early 1980s. A typical incident involved a DPRK diplomat stopped at an international border and found to be transporting an item protected under the CITES. Typically the items were either ivory/raw elephant horn or rhinoceros horn. For example, in an incident in 1999, a DPRK diplomat's wife was stopped in Moscow while traveling from Lagos to Beijing with 85 elephant tusks (about one-half ton of raw ivory.) In a 1998 incident, a third secretary at the DPRK embassy in Zimbabwe was accused of attempting to recruit, arm and finance an eight-man team to poach CITES-listed animals in Mozambique. Reports from conservation NGOs claimed to have located large warehouses of ivory and rhinoceros horn near Hong Kong linked to organized DPRK trafficking.

#### **State Department Action Against DPRK Criminality**

The Department of State is well aware of the possibility that DPRK state-directed criminality could contribute to the financing of DPRK

weapons development by a state that is listed as a state supporter of terrorism and could offer financial support to a state that is otherwise failing economically. The profit realized from these illicit activities could be substantial, although given the covert nature of these activities and the challenge of obtaining reliable information on the DPRK, any estimates are necessarily highly speculative.

The Department has used a number of organizational structures to ensure that information available in law enforcement channels can be compared and coordinated with information available in diplomatic and military channels. Among these structures is the Illicit Activities Initiative (IAI), which was previously managed by the North Korea Working Group, and is currently directed by its successor. The IAI includes several inter-departmental committees, managed by the Department's Office of Korean Affairs in the Bureau of East Asian and Pacific Affairs, with reporting responsibilities to senior officials at each member agency. Under the current arrangement, there is an individual committee dealing with each element of DPRK criminality, including smuggling, narcotics trafficking, and counterfeiting, as well as abuse of diplomatic privileges.

This interagency coordination mechanism is working. For example, the IAI working group on illicit finance coordinated the sharing of intelligence that led to the Treasury Department's designation last September of a bank in Macau -- Banco Delta Asia -- as a "primary money laundering concern" pursuant to Section 311 of the USA PATRIOT Act, primarily based on its links to North Korean government agencies and front companies involved in illicit activities. As a result of that designation, Macanese authorities have taken control of Banco Delta Asia and frozen its DPRK-linked accounts while taking steps to clean up the bank and strengthen anti-money laundering controls. Thus, North Korean illicit actors have been deprived of an important financial hub they once used to facilitate criminal activities and launder the proceeds therefrom, and other banks in the region have been put on alert as to the risks of taking on this type of business.

When the Department of State learns of possible DPRK-linked criminal activities discovered abroad, it attempts to learn more about them and consistently reports its findings in diplomatic fora and in the publicly available International Narcotics Control Strategy Report (INCSR), which is



prepared annually by the Bureau for International Narcotics and Law Enforcement in the Department of State and submitted to the Congress.

On the diplomatic front, we have alerted our allies and friends to the possibility of state-led criminality by the DPRK and encouraged a vigorous law enforcement response. Major narcotics seizures by Taiwan and Japanese authorities demonstrate their commitment and capacity to combat this threat. We have made it clear to the North Koreans and other countries involved within the context of the Six Party Talks that outstanding bilateral issues, including DPRK's involvement in illicit activities, need to be resolved before we can normalize our relations. Further, we have sought and obtained support from our partners in the Six Party talks that the DPRK must abandon such activities if it wishes to normalize its participation in the international state system.

The State Department continues to work with, and acknowledges the critical work being done by, other agencies of the U.S. Government in combating North Korean illicit activities. The Department of Justice is vigorously enforcing laws against counterfeiting, cigarette smuggling and other forms of criminality. Several federal indictments have recently been issued on both U.S. coasts. In August 2005, the Department of Justice announced the indictment of 87 individuals on charges related to international conspiracies to launder money and smuggle counterfeit U.S. currency, weapons, drugs and cigarettes into the United States. The indictments represent the successful culmination of a years-long inter-agency investigation ("Royal Charm") with links to Asian organized crime and the DPRK. Operation Smoking Dragon has resulted in the seizure of \$1.2 million in counterfeit currency to date. The Royal Charm and Smoking Dragon cases are ongoing and continue to yield information on these illicit activities.

The U.S. Secret Service, as described by testimony today, continues to work to combat the production and distribution of U.S. counterfeit currency, including DPRK-produced "supernotes." In addition to its work leading to the Royal Charm and Smoking Dragon indictments, the FBI continues to work with other foreign law enforcement agencies to garner cooperation and additional information related to these cases. Further, the Bureau of Alcohol, Tobacco, Firearms and Explosives, which has contributed to the Royal Charm and Smoking Dragon investigations and has primary jurisdiction to investigate contraband cigarette trafficking (which includes

counterfeit cigarettes), continues to work with the law enforcement community and industry to interdict that source of illicit profit.

The Drug Enforcement Administration (DEA), through the International Drug Enforcement Conference (IDEC), and working jointly with their international counterparts, has been able to maintain a very robust and successful chemical control program based in Hong Kong. As a result of this collaboration, precursor chemical shipments to Mexico, Colombia, and North Korea have been stopped because of suspicious importers.

We will continue to be on guard against the possibility that DPRK-origin narcotics could enter the United States, perhaps through criminal networks that are already trafficking in counterfeit cigarettes to the United States. We will also continue to work with our partners in the international effort against transnational crime, whether it is state-directed or otherwise.

Mr. Chairman, in closing I would like to thank you and the Members of the Subcommittee for this opportunity to discuss narcotics trafficking and other criminal activity with a connection to the DPRK. Focusing the public spotlight on this aspect of DPRK state behavior is one of the ways to increase the risk and deter such criminal activity in the future.

I am happy to answer your questions.

**STATEMENT OF MICHAEL MERRITT**

**Deputy Assistant Director  
Office of Investigations  
United States Secret Service**

**Before the Subcommittee on Federal Financial Management, Government  
Information and International Security**

**Committee on Homeland Security and Government Affairs**

**United States Senate**

**April 25, 2006**

Mr. Chairman, I would like to thank you, as well as the distinguished ranking member, and other members of the subcommittee, for the opportunity to address you today regarding the Secret Service's investigative efforts into the production and distribution of high-quality, counterfeit U.S. currency (Federal Reserve Notes), which in this case are collectively referred to as the "Supernote".

While the public has long associated the Secret Service with our mission to protect the President of the United States and other national leaders, our agency was actually established in 1865 to protect our fledgling financial infrastructure through the investigation of the counterfeiting of U.S. currency. At that time, it was estimated that between one-third and one-half of the currency in circulation was counterfeit and the proliferation of this activity led to the formal establishment of the Secret Service.

For the past 141 years, the Secret Service has investigated counterfeiting offenses, developing a unique and world-renowned expertise. With our prevention-based approach, we have dismantled countless counterfeit manufacturing plants, seized millions of counterfeit notes both domestically and overseas, and provided education and training to foreign and domestic law enforcement in support of a unified effort to stop this activity. We have amassed the most complete and comprehensive library of counterfeit U.S. dollars produced around the world.

The worldwide use of the U.S. dollar as the currency of choice continues to grow. With as much as two-thirds of the approximately \$750 billion dollars of U.S. currency in circulation outside of our borders, the U.S. dollar is truly a global currency. In addition to "dollarized" economies – those nations that have adopted the U.S. dollar as their own currency – businesses and individual interests worldwide depend upon the integrity and stability of the U.S. dollar. This is why counterfeiting activity can have a profound effect on not only our economy, but the international markets as well. Counterfeiting reduces consumer confidence in our currency and has the

potential to affect the perception, and thereby the strength, of the dollar and all dependent economies.

#### **Supernote Origin and Statistics**

The Supernote family of counterfeit notes was first detected in 1989. Its primary significance is that it is of such high quality that it often goes undetected until it reaches the Federal Reserve Bank. Since its initial discovery, the investigation into its origin and distribution has been a top priority for the Secret Service. The Supernote investigation is an ongoing strategic case with national security implications. This investigation has spanned the globe, involving more than 130 countries and resulting in more than 170 arrests.

The Supernote primarily circulates outside of the United States. Though collectively referred to as the Supernote, it is actually a family of different versions of \$100 and \$50 denomination counterfeit notes, all of which are circularized by the Secret Service. These sophisticated counterfeits range from older series \$100 notes which bear the smaller portrait, to counterfeits of more recently redesigned 'big head' notes - to include the latest version of the 2003 series.

The Supernote is printed using the same intaglio and typographic printing methods as those employed by the U.S. Bureau of Engraving and Printing in the production of genuine U.S. currency. The Supernote is also printed on reverse-engineered paper which is of similar composition to that used in the printing of genuine U.S. currency. Present in the Supernote paper are security features such as red and blue security fibers, a security thread, and a watermark. This family of counterfeit notes is continually evolving as we discover better, more deceptive versions of the Supernote. These new versions show corrections or improvements in the flaws which are used by banking and law enforcement to detect them.

Through extensive investigation, the Secret Service has made definitive connections between these highly deceptive counterfeit notes and the Democratic People's Republic of Korea (DPRK). Our investigation has revealed that the Supernote continues to be produced and distributed from sources operating out of North Korea.

The first Supernote was detected by a Central Bank cash handler in the Philippines more than 16 years ago. Since then, the Secret Service has seized approximately \$50.0 million of the Supernote globally, which equates to seizures of approximately \$2.8 million annually. To provide a frame of reference, during fiscal year 2005, the Secret Service seized over \$113.0 million in counterfeit U.S. currency. The amount seized is also comparatively low in contrast to other known counterfeits. For example, during the same timeframe as that of the Supernote investigation, our investigation into counterfeit currency produced in Colombia yielded seizures in excess of \$380.0 million. The amount seized is also low when compared to the large volume of genuine U.S. currency in circulation worldwide.

#### **Quality vs. Quantity**

The high quality of these notes, and not the quantity circulated, is the primary cause of concern for the Secret Service. As illustrated by the aforementioned statistics, the Supernote is unlikely

to adversely impact the U.S. economy based upon the comparatively low volume of notes passed. However, the introduction of the Supernote into a micro economy can have a significant influence, not only due to the monetary losses sustained as a result of the Supernote passes, but also because of the loss of integrity of the U.S. dollar. An example of this effect was seen in Taiwan in 2004 and in Peru in 2005. In both cases, many financial institutions and merchants refused to accept any \$100 notes after the discovery of small caches of Supernotes.

It should be noted that the Supernote, while highly deceptive, is detectable with minimal training. The manual detection process can, however, hinder effective detection. There are also machines which are commercially available that can detect the Supernote. Not all banknote processing equipment has this advanced capability.

#### **Investigative Links/Challenges**

Throughout the 1990s, numerous North Korean citizens traveling throughout Europe and Asia, working in an official capacity, were apprehended by law enforcement for passing large quantities of the Supernote. In each of these cases, the North Korean officials evaded prosecution for these crimes based upon their diplomatic status.

State-sponsorship of the Supernote poses unique and considerable challenges in addressing this issue through traditional law enforcement channels. In response, the Secret Service has developed and employed a three-pronged strategy to address the distribution of this counterfeit.

The first part of this strategy focuses on containment based upon an aggressive investigative response to all appearances of this counterfeit currency. Secret Service agents posted around the world work closely with their foreign counterparts to identify and arrest distributors of this counterfeit as rapidly as possible. Coordination of large-scale investigations internationally can be very difficult, particularly when cooperative efforts and counterfeiting laws differ from country to country.

The second part of our strategy focuses on disruption. With the support of the international law enforcement community through Interpol, this strategy is designed to deny North Korea the supplies and equipment required to manufacture high-quality counterfeit notes. The Secret Service also maintains an ongoing partnership with representatives in the printing industry which contributes to this objective. In support of our ongoing disruption tactics, Interpol issued an "Orange Alert" to all of the Interpol member countries in April of 2005, informing them of the illicit counterfeiting activities emanating from North Korea. This notice called for members of the printing industry to voluntarily refrain from selling certain highly-sensitive printing supplies and equipment to North Korea.

The third part of our strategy focuses on education. The Secret Service provides detailed training seminars to financial institutions and law enforcement personnel across the globe on the detection of counterfeit currency. These seminars are designed to equip cash handlers with the knowledge and understanding necessary to detect these counterfeit notes. In the past year, the Secret Service has provided 138 training seminars in 23 countries, training approximately 7,800 financial institution and law enforcement personnel in support of our education strategy.

#### **Conclusion**

Mr. Chairman, that concludes my prepared statement, and I would be pleased to answer any questions that you or other members of the subcommittee may have.

**Illegal Actions of North Korea**

**Seong Min Kim**  
**Vice Chairman of the Exile Committee for North Korea Democracy**  
**President of Free North Korea Radio**  
**Tuesday, April 25, 2006**

A territory of a nation belongs to that particular nation. But national policies and the process of enforcing the law cannot deviate from the universal ethics and governing principles. Nevertheless, North Korea, under the absolute monarchy of Jung-Il Kim followed by that of Il-Sung Kim, has rejected the universal code of conduct with a tenacious manner.

Recently North Korea has been criticized as an immoral nation by the international community for violating of human rights and illegal actions.

The primary reason why this serious problem has not been highlighted is because North Korea controls public speech and writing. Also, the works of international organizations such as the United Nations and "Reporters Without Borders" have been regulated by North Korean government.

At this point, organizations for North Korean escapees – 8,000 defectors in North Korea, Exile Committee for North Korea Democracy, and 200,000 defectors in China and other countries – has been established in order to report this terrible situation in North Korea. This organization is working as the first step by reporting incidents regarding the violation of human rights, forgery of fake currency, production of illicit drugs and weapons of mass destruction in North Korea.

I had worked as a North Korean soldier, both as a private and a lieutenant for a total of 16 years and entered South Korea in the year of 1999.

Currently I am working as the vice president of the Exile Committee for North Korea Democracy (President: Jang-Yup Hwang) and the president of Free North Korea Radio. I am here to testify about violations of human rights and illegal actions of North Korea based on the individual and group testimonies of North Korean escapees.

It has already been revealed how political criminals are treated in North Korean prisons through the testimonies of escapees like Chul-Hwan Kang, Hyuk Ahn, Young-Kook Lee, and Soon-Ok Lee, who spoke at the United States Senate Hearing.

Also, defectors who were once spies sent to South Korea like Myung-Jin Ahn confirmed a kidnapping of Japanese people by North Korean government.

Marketing of weapons of mass destruction and illicit drug dealings were exposed by Dae-Geun Lee (pseudonym) and Bok-Goo Lee (pseudonym).

These testimonies by North Korean individuals have been concealed by the society defined and established by North Korean illegality, or because of the movements promoting friendship between South Korea and North Korea. Now they are being presented through the activities of the organizations for North Korean civil rights.

There are 2 current issues brought up by North Korean defectors. The first one is North Korean government's violent acts of oppression against the movements working against the corrupting in North Korea. The second is the exploitation of labor in the prisons for political criminals and juvenile detention centers.

There was a recent public spectacle in Northern Hahm-Kyung Province where two persons on March 1, 2005, and one person on the following day, were executed by firing squad because they were helping North Korean escapees.

August of the same year and March of this year, it was revealed to the whole world that one soldier from 27th North Korean borderline defense brigade committed aggravated battery against a female escapee until the weapon was broken. Also, it was exposed to the public that he beat a person, inspected by the security system, with a rifle.

It is unfortunate that South Korea considers the pictures and the video clips from the hidden cameras to be unreliable. However, according to the seminar on "Psychological injury and healing" that was held on April 6, 2006, by "Doctors Without Borders" and "Yonsei Medical University Behavioral Science Institute", 87.3 percent of 200 North Korean escapees have witnessed a public execution.

Like this, execution by firing squad and violence carried out against any groups and individuals opposing Kim Jung Il despotism is pervasive not only in prisons but in all regions of North Korea and is still going on even now.

In addition to this violent policy, a series of evidence and testimonies have shown the infinite exploitation of labors.

The story by escapees from North Korean of forced labor camps is an example.

Song-Jung Kim (pseudonym, 46 years old) who was confined in one of the camps for 14 years and finally escaped North Korea in 1999 said that "There are over 1,000 people who died in the forced labor camps, from the pain and suffering while working more than 10 hours everyday to make furniture for North Korean government officials" and "their bodies are buried in hills near the camp with other trash."

At "Promoting Human Rights in Korea" that was held in Seoul in November, 2005, Keum-Soon Choi, an escapee, shared her story. She testified about her life in a North Korean prison where she was forced to work heavy labor while being given less than 100 corn seeds and salt soup as her daily food. She also said that in a camp located in Poong-Duk city, Northern Pyung-Ahn Province, she was to wake up at 4 a.m., have breakfast, and go out in the field to work until 10 p.m. and 12 of her fellow workers passed away in 1 year.

Compulsory labor, even for children, women, and the elders, is prevalent in the 10 prisons for political prisoners and the 20 jails, the re-education centers. It has been found that North Korean government secretly sells the products made by political prisoners as bicycles, daily necessities, and military materials made by these workers at international level with no paying to these workers.

North Korean opium cultivation known as "white peach" also part of the slave labor is sold by government.

Furthermore, every school aged child must work for at least 3 months of agriculture as slave laborer. They do not get paid for their work. They could not eat the food enough. All of it goes to the regime.

North Korean government started its secret opium cultivation in northern area of country, around the year of 1983. The government placed discharged soldiers at a large opium farm in Yun-Sah province in Northern Hwang-Hae, Boo-Ryung province in Northern Hahm-Kyung, and Jang-Jin province in Southern Hahm-Kyung. For three years, those workers were only given food to survive without getting paid and accomplished the order of the supreme commander of military, Kim Jung Il.

In addition, soldiers work without payment for 10 years in coal mine in Pyung-Yang city, gold mine in Northern Pyung-Ahn province, zinc mine in Northern Ham-Kyung province in order to earn cash for the regime to buy foreign goods. Some soldiers such as those in the army corps located at Geum-Gang Mountains are engaged in this ridiculous national policy from the first day they are drafted into the army.

There is a problem in the secret international sales of the valuables, opium, controlled goods produced by the forced labor. But also, this continued violation of human rights by the power of the regime in North Korea should be condemned by international community.

It would not be possible to discuss all the atrocities taking place inside the iron veils of North Korea. That would take many days and nights of discussion. Even then, that would not be sufficient. Instead, I would like to conclude my remarks by telling you about writing by a teenager escapee.



The teenager was 13 years old when he was forced to work on a farm under the guise of "farm support." The work on the farm was a heavy burden for this youngster. The work would have been difficult even for a grown up.

One day, the teenager found intestines to a goat in the trash dumpster. They were thrown away by soldiers. After washing them twenty times or so, the stench became mild. After boiling them three times, they were somewhat edible. He shared the intestines with his sister. He stated in his writing that the goat intestines were the most delicious things in the world.

His writing made a big news in South Korea. It also exposed the dark realities of North Korea.

North Korean regime forces young children to the fields under the guise of "farm support." During the Spring, children are sent to the fields for 40 days. During Autumn, they are subjected to 30 days of forced labor.

Children would be planting seeds for corn and rice stocks.

In the provinces of Hamhaebuk-do and Hamkyungbuk-do, there are large scale farms for growing opium. Students in nearby schools work on the fields to gather the opium extracts and to dry opium flowers and stocks. Those activities are carried out at the directions of their teachers and the state.

It is a well known secret that hard currency collected from sales of opium produced with forced labor from children, golds mined, collected from slave labor in the Czech, Russia and counterfeit moneys which is laundered by diplomats is deposited in the banks in Macao and Switzerland. The money is a slush fund for Kim Jung Il's personal use.

Kim Jung Il holds out that he has no money to buy corns for the starving people of North Korea. At the same time, he has his money for catering to his personal needs. He has spent 900 million dollars worth of money to permanently conserve the deceased body of his father. He is spending astronomical amount of money for his nuclear program. Yet, he has no money for the people. Kim Jung-II is no ordinary sinner that can be forgiven. He is the Satan himself. He must not be forgiven.

Once Kim Jung Il is expunged and a new democratic government is established in North Korea, the problems of human rights abuse, and other criminal activities that have been plaguing the world community will all be yesterday's news. There various means to achieving unconditional surrender from Kim Jung Il.

One of those means would be to freeze his slush funds resident in the Switzerland bank accounts. I implore the U.S. congress to investigate Kim Jung Il's accounts in the Switzerland banks and freeze those accounts.

Furthermore, there are many testimonies of escapees against North Korea including oppression and criminal acts against the population that will be revealed to the United States, Europe, United Nations, and Non-Governmental Organizations in all the countries through "White Paper on Human Rights in North Korea" being prepared by the Exile Committee for North Korea Democracy.

I hope these activities of North Korean escapees for improvement of human rights in North Korea will be supported by the international community and expect North Korea Democracy movements will overthrow the absolute monarchy of Jung-Il Kim. Lastly, I want to express my gratitude to the United States Senate and Ms. Suzanne Scholte of the Defense Forum Foundation who always pay attention and show interest in the North Korean defectors. Thank you very much.

Statement of

David L. Asher, Ph.D.

Before the  
Subcommittee on Federal Financial Management, Government Information,  
and International Security  
Senate Homeland Security and Government Affairs Committee  
April 25, 2006

Mr. Chairman, ranking member Carper, and other distinguished members, I appreciate the opportunity to address this subcommittee on the topic of "the Illicit Activities of the Kim Jong Il regime."

Allow me to make the obligatory preface that I am speaking in a non-official capacity. In mid-July of 2005 I left the Department of State, where for the four previous years I had been privileged to serve as the Senior Advisor for East Asian and Pacific Affairs. From 2003-2005, I also coordinated the Department's North Korea Working Group and co-chaired an inter-agency coordinating committee on DPRK illicit activities for the NSC.

In this submitted testimony I try to address the following five key questions:

- I. What is going on and where?
- II. How much is going on?
- III. Who is doing it?
- IV. What was the US Government reaction? – the Illicit Activities Initiative
- V. What are Current US Policy Implications?

Let me start by noting the North Korean government's official position on its relationship to illicit activities and trans-national organized crime. North Korea's official press agency, KCNA, has declared that its government does "not allow such things as bad treatment of the people, counterfeiting and drug trafficking." In another statement, the DPRK asserted, "We had neither counterfeited currency nor gotten involved in any illegal trafficking." On April 19<sup>th</sup> KCNA went so far as to charge that "forces hostile to the DPRK, including those in the U.S. and Japan, are working hard to fabricate what they call "evidence" and "proofs" by employing every conceivable means and despicable method to brand the DPRK as a "criminal state" and "lawless state" over "human rights abuse", "drug smuggling" and "counterfeit notes.""

Despite such propagandist denials, the rise of the North Korean criminal state is no secret. Over the last decade and a half, as the industrial economy of Kim Il Song has collapsed, North Korea's government has officially embraced criminal activities as a means of providing financial support for the leadership, many of whom have been personally involved. Hundreds of incidences of criminality by officials, embassies, trading companies, and intelligence officers have been detected around the globe. While most of these have not been given great publicity, enough have to present a picture of a clear trans-national criminal conspiracy.

### I. What are they doing and where?

DPRK linked illicit trading networks exist on every continent today – increasingly in partnership with organized crime groups. They are engaged in a remarkably wide range of activities – be it heroin dealing in the Russian Far East or the Australian Southeast; buying and selling cocaine in Latin and South America; distributing genuine-looking counterfeit US currency – so called supernotes – everywhere from Macau and Manila to Lima and London; marketing counterfeit cigarettes from Germany and Greece to India and Indonesia; trafficking methamphetamines in Tokyo and Taipei, conveying African rhino horn and elephant tusks into Southern China and Vietnam for sale; and smuggling or holding humans for prostitution or forced labor in China, Cambodia, and the Middle East. These networks have even been linked in the past to abductions of innocent civilians in Japan, the ROK, Thailand and elsewhere.

North Korean illicit activities also have touched US soil. Four years ago industry sources discovered that North Korean counterfeit cigarettes apparently were coming into the US through Chinese organized crime channels. To document and uncover this network, the FBI and the Secret Service joined together in a brilliantly conceived undercover investigation, codenamed “Royal Charm.” Royal Charm was centered on a false-front Mafia group in northern New Jersey, somewhat reminiscent of the one on the TV hit, the Sopranos. This front-family had been established in the late 1990s as part of an FBI ruse to penetrate the counterfeit cigarette trade between China and the US, but was expanded rapidly as linkages to the DPRK became apparent (industry sources had discovered that contraband produced in the DPRK was falsely labeled as coming from China and shipped through Chinese ports to escape scrutiny). The criminals on the East Coast were engaged in a partnership with another group on the West Coast, who were targets of a related investigation, “Smoking Dragon.”

Through Royal Charm and Smoking Dragon an expansive network in the US linked to North Korea and Chinese criminal partners was documented. This network, as the unsealed indictments show, was engaged in selling tens of millions of dollars per year of contraband – everything from counterfeit US currency, counterfeit US postage stamps, counterfeit US branded cigarettes and state tax stamps, counterfeit Viagra, ecstasy, methamphetamine, heroin, AK-47s, and even attempting to sell shoulder fired missiles (manpads) and rocket propelled grenades (RPGs) into the US.

The investigations culminated in a much publicized event, a “wedding,” in which the supposed daughter of the FBI undercover “mob boss” was to be married on a yacht, the Royal Charm, moored in Atlantic City harbor. Unwittingly, a large number of crooks flew in from across the US and northeast Asia to attend the nuptial celebration. Instead, of riding in their limousines to the imaginary Yacht – they found themselves being taken to the Newark courthouse to be booked. Among them was Jyimin “Jimmy” Horng – who with his accomplice Co Khan, aka “Keith” Tang, apparently had arranged large shipments of DPRK supernote and meth into the US and planned to sell a range of weaponry to the US undercover agents with the help of generals from “two un-named countries.”<sup>1</sup>

<sup>1</sup> MACAU, China (UPI) – August 25, 2005 “Two Asian men accused of smuggling weapons and counterfeit bills into the United States laundered \$1.15 million in Macau bank accounts, U.S. investigators said. Co Khanh Tang and Jyimin Horng are among 87 alleged members of a criminal syndicate accused by the U.S. government of smuggling weapons, counterfeit money, drugs and fake cigarettes into the country, the South China Morning Post reported Thursday. Agents arrested 59 people last weekend, most of them in a New Jersey sting operation that lured suspects to a mock wedding party aboard a luxury yacht. Tang and Horng reportedly received \$1.15 million from undercover law enforcement agents in exchange for \$3.35 million of high-quality counterfeit dollars.” The men also received a \$50,000 deposit toward a \$1 million

## II. How Much is Going on?

Frequently one gets asked, "how much of this stuff is going on?" Although it is hard to pin down the exact scale of DPRK illicit activity at an unclassified level (and not easy even with classified sources), by going backward through the partner country trade statistics and drawing on reported law enforcement seizures, we can make a rough guess. Based on these methods, we can surmise that the sum of activity is in the range of \$450-550 million per year.<sup>2</sup> This may not sound like much, but it could be as much as 35-40% of DPRK exports and a much larger percentage of its total net cash earnings (conventional trade profit margins are low but the margin on illegal businesses is extremely high, frequently over 500%).

The following five areas seem to be most important in terms of income to the leadership:

### 1. Counterfeit cigarettes

Domestically produced counterfeit cigarettes may now be the largest export, by value, for North Korea, with containerized cargoes frequently coming from the ports of Najin and Nampo for shipment via major ports in China and the ROK throughout the world. Over the last four years, in parallel and in support of the US law enforcement investigations, several leading members of the international cigarette industry commenced their own sophisticated undercover investigation into this trade. Recently a report from this investigation was quoted in the media. The report observes:

"The Democratic People's Republic of Korea (DPRK) has emerged in the past five years as one of the principal sources of counterfeit international brand cigarettes. Reporting from informants, undercover investigators, and industry insiders indicates that between 10 and 12 factories are – or recently have been – actively producing counterfeit cigarettes in the country. Six of these factories are located in P'yongyang or its suburbs, while as many as six are in or near the Rajin area on the north east coast of the DPRK. We assess that total production from these factories could equal some 41 billion sticks, or four million master cases, annually (see chart).... The DPRK military and internal security service respectively also reportedly own and run at least two of the factories (Dongyang Cigarette and Linglou Island 888 Cigarette factories....Reporting from [industry] intelligence sources, as well as information generated during the course of conducting controlled buys, indicates that DPRK-origin counterfeits have been selling at between

---

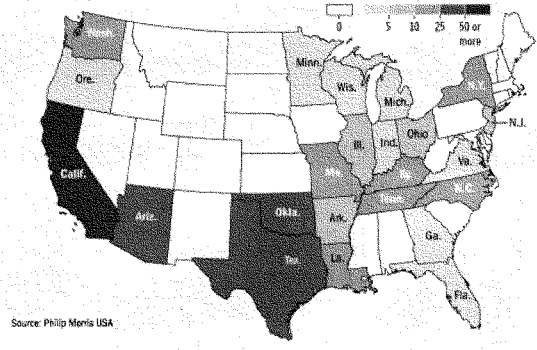
shipment of arms, including 75 anti-tank missiles, 50 rocket-propelled grenade launchers, 1,200 AK-47 assault rifles and various other firearms, the newspaper said. Horng allegedly planned to smuggle the weapons into the United States with the help of two military generals in two unnamed countries. Tang and Horng had payments deposited into a Bank of China account in Macau and an International Bank of Taipei account in Taiwan, the report said. Spokesmen at both banks declined to say whether the accounts had been frozen."

<sup>2</sup> In 2003 the DPRK ran a trade deficit of at least \$835 million that if more broadly measured to exclude concessionary trade with the ROK and China probably was more like \$1.2 billion. Even making a very bold estimate for informal remittances and under the table payments for that year, the DPRK probably ran a current account deficit of at least \$500 million. Moreover, North Korea's accumulated trade deficit with the ROK and China alone since 1990 is over \$10 billion. North Korea has not been able to borrow on international markets since the late 1970s and has at least \$12 billion in unrepaid debt principal outstanding. Yet, it has managed to avoid self-induced hyper-inflation (which should have occurred given the need to reconcile internal and external monetary accounts, even in a communist country). Instead, the street stalls in Pyongyang and other North Korean cities seem to be awash in foreign made cloths, food, and TVs and the quality of life of the elite seems to have improved. Crime apparently is filling a large part of the gap and helping account for the apparent improvements to the standard of living for the elite.

US\$130- to US\$180 per master case [at] a nearby Asian port (Busan, Manila, or Kaohsiung). At these rates, the [North Korean counterfeit cigarette industry] could generate between US\$520 to US\$720 million in gross revenue annually.”<sup>3</sup>

### Tracking Fake Smokes

Incidents of counterfeit cigarettes from North Korea discovered from January 2002 through Sept. 2005, by state



### North Korea's Counterfeit Cigarette Production Facilities

#### Estimated Production Volume for DPRK

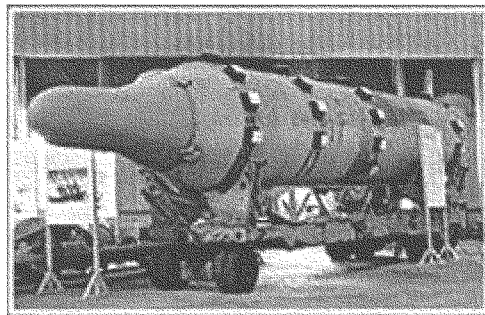
Factory	Number of Makers	Cigarette per Minute	Cigarette Per Hour (Sticks)	Cigarette Per Day (Sticks)	Cigarette Per Month		Cigarette Per Year	
					Sticks	Master Case	Sticks	Master Case
Rajin Cigarette Tobacco Company	YJ14 x 2	4,000	172,800	4,147,200	124,416,000	12,442	1,513,728,000	151,373
	YJ13 x 1	1,600	69,120	1,638,880	49,766,400	4,977	605,491,200	60,549
	Total	5,600	241,920	5,786,080	174,182,400	17,418	2,119,219,200	211,922
San He Bao Shui Joint Venture Company								
1. Mild Seven Factory <sup>3</sup>	YJ14*2	4,000	172,800	4,147,200	124,416,000	12,442	1,513,728,000	151,373
2. Marlboro Factory <sup>3</sup>	YJ14*2	4,000	172,800	4,147,200	124,416,000	12,442	1,513,728,000	151,373
3. WU's Factory <sup>3</sup>	YJ14*2	4,000	172,800	4,147,200	124,416,000	12,442	1,513,728,000	151,373
	Total	12,000	518,400	12,441,600	373,248,000	37,325	4,541,184,000	454,118
Shengping Cigarette Factory <sup>3</sup>	YJ14 x 2	4,000	172,800	4,147,200	124,416,000	12,442	1,513,728,000	151,373
Daejeong Cigarette Factory					60,000,000	6,000	720,000,000	72,000
Dougyang Cigarette Factory					280,000,000	28,000	3,360,000,000	336,000
Long Cheng Cigarette Factory <sup>3</sup>	YJ14 x 2	4,000	172,800	4,147,200	124,416,000	12,442	1,513,728,000	151,373
P'yongyang Cigarette Factory					500,000,000	50,000	6,000,000,000	600,000
Jun Ha Radio Factory <sup>3</sup>	YJ14 x 2	4,000	172,800	4,147,200	124,416,000	12,442	1,513,728,000	151,373
Tae Dong River Cigarette Factory	Mk9-5 x 3	15,000	648,000	15,552,000	466,560,000	46,656	5,676,480,000	567,648
	Mk9 x 2	8,000	345,600	8,294,400	248,832,000	24,883	3,027,456,000	302,746
	Mk8 x 8	16,000	691,200	16,588,800	497,664,000	49,766	6,054,912,000	605,491
	YJ13 x 8	12,800	552,960	13,271,040	398,131,200	39,813	4,843,929,600	484,393
	Total	51,800	2,237,760	53,706,240	1,611,187,200	161,119	19,602,777,600	1,960,278
Lingdon Island 888 Cigarette Factory <sup>3</sup>	YJ14 x 2	4,000	172,800	4,147,200	124,416,000	12,442	1,513,728,000	151,373
Total Production for DPRK					3,416,381,600	341,628	41,438,892,800	4,143,809

## 2. Weapons:

<sup>3</sup> See Coalition of Tobacco Companies Report, "Production of Counterfeit Cigarettes in the Democratic People's Republic of Korea (DPRK)," June 29, 2005

The government of North Korea and its trading companies remain significant players in the global weapons trade, most importantly in the area of ballistic missiles. In the last decade the DPRK has reportedly sold or marketed missiles to countries ranging from Egypt, Syria, and Yemen to Venezuela, Nigeria, and Burma.<sup>4</sup>

The government of Iran, long the DPRK's best customer for missiles and other weapons, apparently has significantly expanded its ties to North Korea. On December 16, the German newspaper Bild reported that the German National Intelligence Service had recent information that Iran had bought 18 disassembled BM-25 missiles from North Korea – a report later confirmed by German diplomats.<sup>5</sup> The BM-25 missile is based on the Soviet SS-N-6 ballistic missile and is alleged to be capable of delivering nuclear payloads to almost every Western European capital and to Israel. The sale of the BM-25 to Iran by North Korea represents perhaps the most serious proliferation of a missile to another country ever.



Soviet SSN-6 Ballistic Missile (source: *Janes*)

One wonders why Iran would wish to procure such a provocative and dangerous missile if it did not have weapons to deliver with it. Indeed, if North Korea could successfully export a large number of intermediate range missiles to Iran under the radar screen of our intelligence community and the Proliferation Security Initiative, could it also have exported a nuclear weapon or related technologies without our knowledge? It is hard to believe the DPRK would cross such an obvious red-line and I know of no information that such a WMD sale somehow occurred under our watch. Nonetheless, North Korea's export several years ago of uranium hexafluoride gas (UF<sub>6</sub>) to Libya, for its incipient highly enriched uranium based nuclear weapons program, indicates that the DPRK may be far more willing to engage in clandestine WMD cooperation than many analysts assess. Moreover, not only is the state of DPRK-Iran relations evolving in a dangerous manner – with both sides heralding their 'eternal friendship and solidarity' in recent statements – specific forms of WMD-related cooperation are emerging in the public eye. For example, on January 25<sup>th</sup> *Janes Defense Weekly* reported that Iran and North Korea have signed joint-venture contracts in which selected companies are involved in "intensive construction and maintenance work for massive shielding of the tunnels branching to the facilities at Natanz and Isfahan." If the DPRK is ready to help protect Iran's nuclear facilities and sell missiles to deliver

<sup>4</sup> <http://www.wisconsinproject.org/countries/nkorea/north-korea-miles.html>

<sup>5</sup> "Iran's missile tech suppliers named," February 8, 2006, Louis Charbonneau, Reuters

Iranian nuclear weapons, I see no reason to think they would not be willing to provide clandestine technical assistance with the Iranian nuclear weapons program itself.<sup>6</sup>

Impeding the formation of a genuine axis of evil, cemented by nuclear and missile cooperation, is an extremely high priority for the Bush Administration. However, the US will need much greater cooperation from China, Russia, and other geographically proximate states to be successful in containing and deterring this proliferation and political threat. The focus of the international community needs to be not just on Iran but also on its key partners, with North Korea at the forefront.

### 3. Drugs

DPRK state directed narco-trafficking continues as a major income generator, some estimate \$100-200 million per year. Among others, Nanam Pharmaceutical Factory, Mannyun Pharmaceutical Factory, and Sujong Joint-venture Trading have been repeatedly implicated by defectors in the ROK press as major producers. If these reports are true, then supposedly legitimate state-run pharmaceutical factories also are being used for the purpose of illicit drug production.<sup>7</sup>

China continues to be the major market for North Korean drugs with the Russian Far East probably coming in second. In China the situation became so bad that in March of 2004 the Vice Minister of the Ministry of Public Security called a highly unusual "press conference" to announce his determination to cut into DPRK drug rings, selling heroin and methamphetamine, in Jilin province on the border with North Korea.

From 1998-2002 Japanese police interdicted nearly 1500 kg of meth that in six separate prosecuted cases was shown to have originated in the DPRK. Nations farther afield, such as Australia, Thailand, the Philippines, Turkey, Bulgaria, and Egypt, among others, have been victims of DPRK narco trafficking in the last few years.

Although the number of reported seizures in Asia has declined dramatically, my guess is that this decline largely reflects the DPRK's adoption of alternative means for bringing drugs into Japan, Korea, and China including, more small boat deliveries and use of Chinese triads, Russian Mafia, and Korean gangs as well as human "mules" to smuggle material on or inside their person. A final, important reason we have seen less high profile seizures is that they have shifted business lines. The key new aspect of drug trafficking is the counterfeit pharmaceutical area, where margins are even higher than in normal drug trafficking. According to industry sources, this is a multi-billion dollar global business, overall, and we have found it to be one the North Koreans, in partnership with Chinese gangs, have targeted aggressively.

---

<sup>6</sup> Undoubtedly, the more North Korea faces financial and political isolation, the more incentive it will have to provide WMD materiel and assistance to a like-minded state like Iran that is willing to give it precious financial support in return and also could be drawn on as an ally in a future crisis. The incentive is increased to the extent the DPRK's own stockpile of weapons grade nuclear materiel expands beyond its immediate needs and it views extending its deterrence abroad as expedient rather than a trigger for a US pre-emptive strike (if it feels confident it could engage in WMD proliferation without detection then it might risk such inherently dangerous proliferation).

<sup>7</sup> Something that would help explain the exceptional purity of narcotics emanating from the DPRK, such as the heroin captured from the North Korea, Pong Su, or the methamphetamines seized in Japan.



#### 4. Production and international distribution of counterfeit currency

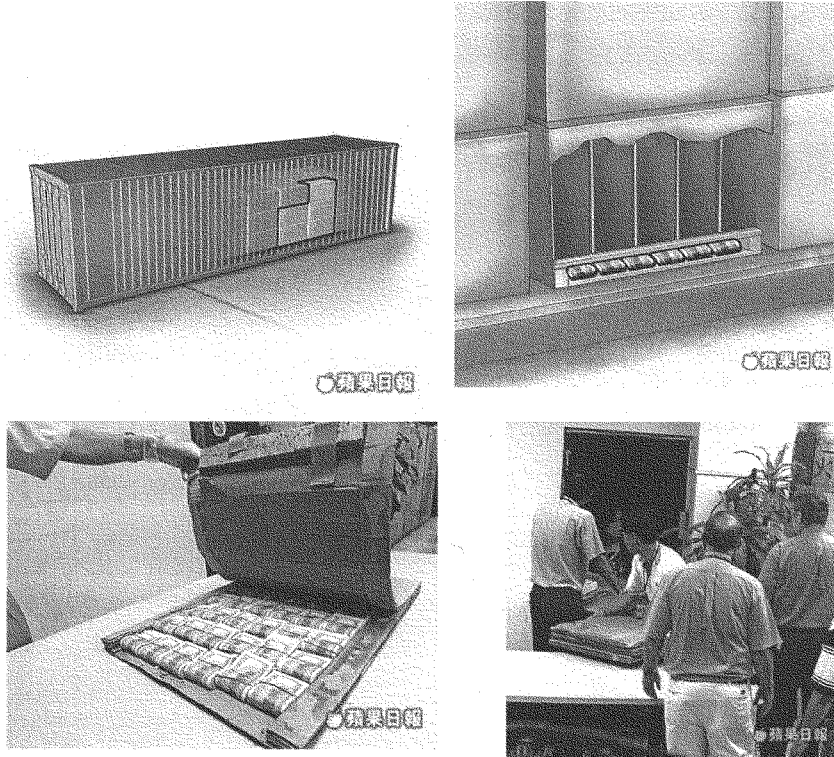
Under International Law, counterfeiting another nation's currency is an act of *causus belli*, an act of economic war. North Korea has been counterfeiting the dollar, and possibly other currencies of importance as well, the entire time it has been on the international engagement bandwagon since the late 1980s. What does this say about the regime's intentions?

As the August 8, 2005 DOJ indictment of Sean Garland and other members of the Official IRA for their partnership in the criminal distribution of counterfeit US currency reads: "Beginning in or about 1989, and continuing throughout the period of this Indictment, a type of high-quality counterfeit \$100 FRNs began to be detected in circulation around the world. Their high quality made it particularly difficult for them to be detected as counterfeit by untrained persons. The United States Secret Service initially designated these counterfeit notes as "C-14342" and they came to be known as "Supernote" or "Superdollar." Quantities of the Supernote were manufactured in, and under the auspices of the government of, the Democratic People's Republic of Korea ("North Korea"). Individuals, including North Korean nationals acting as ostensible government officials, engaged in the worldwide transportation, delivery, and sale of quantities of Supernotes."

The Royal Charm and Smoking Dragon indictments revealed a willingness to sell millions of dollars in DPRK supernotes into the US by Asian organized criminals linked to the North Korea government. Whether this was a deliberate act of policy decided in Pyongyang or just business among crooks is hard to tell, but it seems unusual that according to the public indictment the cost of the counterfeit notes was less than 40 cents per dollar. This price was far below the market value associated previously with the counterfeit supernotes which, given their ability to be circulated without ready detection by the naked eye, can demand a very high mark-up. One wonders how supernotes at such a low price could be sold, unless the notes were coming from a high source inside the country in question that wanted to see them marketed into the US.

The Secret Service has detected roughly \$50 million of these supernotes in the last sixteen years. Some argue that this shows that the impact of North Korean counterfeiting of the dollar is just a drop in the bucket. Let me argue against this view. First, although supernotes definitely can be detected, the notes are of such high grade that they often circulate as "genuine" currency. Largely this is because they are primarily distributed in the economies of Asia, the former Soviet Union, Africa, and the Americas where the dollar functions as a parallel currency and major money center banks that process currency with technologies capable of detecting the counterfeit notes are few. Another reason for the low amount of detected circulation is that the banks themselves only lose money if they allow the notes to be turned over for processing back to the US. They receive no compensation for being honest. If they unwittingly accept supernote deposits, bank tellers and bankers may well recirculate them along with genuine currency in order to escape taking a loss. They can do this successfully because to almost everyone the notes appear genuine and can be passed as "real." Thus, for these reasons there could be a lot more of the notes out there than we can document.

The relatively sophisticated shipping methods for transporting supernotes uncovered in the FBI-USSS Royal Charm/Smoking Dragon investigations also helps show why so few of the notes are seized before being distributed. The following pictures, reproduced from a Taiwanese newspaper article illuminate how they move the notes around, falsely manifesting the cargo as a non-dutiable item (in this case as "toys"), falsifying port of origin information (to indicate a port in Northern China instead of in the DPRK), and cleverly concealing the contraband.



Finally, let me briefly comment on the impact of the circulation of supernotes on confidence in the dollar. Thankfully the appearance of what at most is several hundred millions of dollars in supernotes has not had a major impact on the strong confidence that people have in the hundreds of billions of genuine dollars in circulation globally. Nonetheless, the impact is hardly insignificant. First, a little supernote can go a long way toward causing instability. In the summer of 2004, a significant sum of supernotes – in the millions – was circulated by a criminal gang in Taiwan. As the notes were detected, confusion set in among summer travelers who had exchanged Taiwan dollars for tens of millions of US dollars. The Central Bank of Taiwan decided to put out a warning advising that counterfeit notes of extraordinary quality were circulating and that people in possession of CB-series US \$100 bills should have them checked for authenticity at banks. This caused a panic as people rushed to turn in several hundred million dollars in a rush – it was a localized “run” on the dollar. I can’t get into details but this was not the first such instance (although perhaps the most alarming). Second, it was just announced that the US Treasury next year will begin circulating new \$100 bills, incorporating sophisticated and costly new anti-counterfeiting features. The new \$100 bills are part of the second major redesign of our currency since 1996. The cost of printing and introducing the new notes (and withdrawing the old ones) will be large, hundreds of millions of dollars, potentially. As in 1996, there is only one major reason for the new redesign: North Korean counterfeiting. Thus, in the end, America will

be incurring many hundreds – not tens – of millions, of dollars in costs and damages as a result of North Korea's counterfeiting of the dollar.

**5. Smuggling sanctioned items, including conflict diamonds, rhino horn and ivory, and endangered species, utilizing official diplomatic means**

This is one of the most outrageous and unacceptable of the DPRK's criminal acts, absolutely contravening international laws, including the Convention on International Trade in Endangered Species of Wild Fauna and Flora. There are numerous notorious examples to cite. In the early 1980's, five North Korean diplomats were forced to leave Africa for their attempts to smuggle rhino horns. The horns were transported from Luzaka to Addis Ababa to South Yemen. From there, they traveled to the consulate in Guangzhou, which ran operations in Macau, Zhuhai, and Hong Kong. This kind of activity has apparently not changed. As Stanford researcher, Sheena Chestnut, noted in a 2005 thesis, in the years since 1996, "at least six North Korean diplomats have been forced to leave Africa after attempts to smuggle elephant tusks and rhinoceros horns." Ivory seizures directly linked to North Korean officials amounted to 689 kg in Kenya in 1999; 537 kg in Moscow in 1999; and 576 kg in France in 1998. I don't have more recent data I can share publicly but I don't think they have given up on the illicit ivory trade.

**III. Who is doing it?**

For many years key organizations that support the North Korean leadership have been linked by defectors to the production and distribution of illicit items. These include numerous state trading companies, the Military Security Command,<sup>8</sup> the Central Bank, Office 35 (the main intelligence service), Office 39 (in charge of managing leadership finances),<sup>9</sup> and the Operations Department of the Korean Worker's Party, which is alleged to play a central role in abductions, covert action, and espionage as well as serving as elite bodyguards.<sup>10</sup> I can't really comment on who does what without getting into classified territory. However, it should be obvious that numerous parts of the North Korean government are involved.

Senior North Koreans abroad, even members of Kim Jong Il's family and inner circle, have been caught distributing counterfeit US currency and other illegal items on many occasions. The large number of incidences of official North Koreans being caught committing crimes is not surprising. North Korea is perhaps the only country in the world whose embassies and overseas personnel are expected to contribute income to the "Party Center," not rely on central government funds for their operations. Such repeated illicit actions from diplomatic premises amount to a serial violation of both articles 31 and 41 of the Vienna conventions on Diplomatic Relations, which respectively convey that A. commercial, and most certainly, criminal activities for profit shall not

<sup>8</sup> "Military Security Command (Bowe Saryongboo) and drug trade," Back to Pyongyang.org, [http://www.backtopyongyang.org/North\\_Korean\\_drug\\_trade.html](http://www.backtopyongyang.org/North_Korean_drug_trade.html) The article states: "According to Kim Duk Hong who defected to South Korea in 1997, his former interpreter, Yu Chul, went to work for Ri Young Man who headed the 7-men export unit for the bureau in charge of drug trade within North Korea's Military Security Command. Ri Young Man is a son of Ri Geun Mo, a former premier and, later, a party secretary of North Hamgyong Province. They export heroin that is produced within the Military Security Command hierarchy and by the Ranam Pharmaceutical Mfg. Plant. Sujong Trading Co. under this Command superficially deals in Kangwon-do spring water and used Japanese cars, but is highly suspected to be involved in drug deals as it is headed by someone who used to sell illegal drugs in Macao before."

<sup>9</sup> See Sheena Chestnut, "The 'Sopranos State'? North Korean Involvement in Criminal Activity and Implications for International Security," <http://www.nautilus.org/napsnet/sr/2006/0605Chestnut.pdf>

<sup>10</sup> The Secretive Operations Department of the Workers' Party, February 6, 2002, <http://www.chosun.com/w21data/html/news/200202/200202060227.html>

be conducted by accredited diplomats or via accredited facilities and B. mandate that officials posted abroad must obey the laws of the nation to which they are posted. The DPRK routinely pays no attention to either critical provision of the Vienna conventions.

#### **IV. America's response: the Illicit Activities Initiative**

Three years ago Assistant Secretary Kelly and Deputy Secretary Armitage asked me to put together an initiative to counter North Korean illicit activities. This decision was born out of a comprehensive review of North Korea's economy that had been conducted over the previous year – a project that had identified an alarming build-up in trans-national criminal dealings by the DPRK in the previous decade. In March 2003 State requested that DOJ look into the issue of North Korean criminal violations of US law. DOJ appointed a highly capable senior prosecutor, Suzanne Hayden, who was charged with pursuing the evidence trail wherever it might lead.

In April 2003 we launched an inter-agency effort under the auspice of the East Asia PCC. This became known as the Illicit Activities Initiative (IAI). To oversee the IAI and provide policy planning support for the Six Party Talks, in the summer of 2003 the Department established the North Korea Working Group, under the Office of the Deputy Secretary. I was appointed as special coordinator and William Newcomb, a senior Asia economic analyst in the Intelligence and Research Bureau, was made my Deputy. We operated out of an office on the 7<sup>th</sup> floor and had the authority to represent the Department at meetings related to our work at the NSC, which eventually established a special inter-agency coordinating committee that I co-chaired.

I want to underline that the IAI was never designed as a substitute for diplomacy. Assistant Secretary Kelly and I considered our work in the Six Party Talks, in which I participated as his advisor, to be of paramount importance. We felt that the US needed a strong two-track policy, with both tracks directed toward creating the grounds for a normalized relationship with the DPRK. On track one we needed an empowered negotiator, equipped with a broad series of transformational incentives to push the denuclearization process forward in concert with the other parties. On track two we needed a process that would hold the North Koreans to a normal standard of behavior in the international community by enforcing our laws while also guarding our flank more effectively against the growing threat of weapons proliferation.

The IAI eventually came to involve 14 different US government Departments and Agencies and well over a hundred policy officials, intelligence analysts, and law enforcement officers. We had superb inter-agency cooperation and strong support from our leadership, all the way up to President Bush. This was a major team effort. Although I may have been the quarterback, the coaches and players deserve most of the credit. Between the spring of 2003-and summer of 2005 we briefed and enlisted the cooperation of around 15 different governments and international organizations. We developed a range of sophisticated policy options and plans, including the careful use of the USA Patriot Act and other tools to cut off North Korea's access to its network of illicit banking partners around the world. We instigated and coordinated the interdiction of contraband internationally and helped to shut down front companies and illicit trading networks. We also worked assiduously to provide support to our US law enforcement brethren. As noted before, the IAI spawned multiple large-scale US international criminal investigations. These involved the US Secret Service, Federal Bureau of Investigation, DEA, ICE, and ATF and many foreign partners. The results of these investigations for the most part have yet to see the light of day but I am confident that when they emerge, the allegations of state-led North Korean criminal activity will be more than fully born out.

### US Policy Implications:

Let me close with a review of five implications for current US policy. First, law enforcement efforts and diplomatic outreach under the Illicit Activities Initiative need to be continued. I am very pleased that the work I started continues and I have great confidence in my former colleagues' determination to press on, both on the diplomatic and law enforcement tracks. Nonetheless, strong inter-agency coordination, calibration, and, most importantly, leadership are essential. Management structures for coordination need to be centralized, not dispersed, and those in charge need to be sufficiently highly placed and properly empowered to do their jobs effectively.

Second, we all need to better guard our flanks against the DPRK proliferation threat. As I have recommended on previous occasions, we need to take more aggressive protective measures, including enhancing the PSI to ensure that no North Korean flagged or leased vessels can travel far outside their waters without inspection and adopting a coherent disruption strategy against their proliferation trading company networks. In addition, there are several thousand containers each year coming out of North Korea from its two main container cargo ports: Najin on the east coast and Nampo on the west coast. To get into the international maritime transport system, they have to go through friendly ports, typically Pusan in the ROK and Shanghai, Hong Kong, and Dalian in China. Only some of these containers are subject to inspection in the ROK (although the ROK is making improvements) and none that I am aware are inspected in China. All first-receiving ports of conveyance for DPRK cargoes need to be held responsible for inspecting containers to ensure that the DPRK does not ship WMD or contraband into the international system.

Third, law enforcement and counter-proliferation are not inherently antithetical to a diplomatic engagement strategy. In this regard, let me note that there likely will be no diplomatic progress if the DPRK's incentive structure does not change. Those who support the positive forces of "sunshine" (engagement) should understand that to the extent the DPRK leadership can rely on a "moonshine economy" it will have little to no incentive to embrace reform. Thus while for the US and other partner states law enforcement and diplomacy are on separate tracks, aggressive law enforcement clearly supports the goal of influencing the DPRK leadership to make a positive strategic choice by making its current criminal framework unsustainable.

Fourth: Change needs to begin in Pyongyang, much more than in Washington. It's in North Korea's objective interest to shift directions. Despite its profitability, crime and WMD proliferation are not a rational or sustainable basis for the DPRK's long-term survival; nor is nuclear coercion—as Secretary Powell used to tell us "they can't eat nukes." The DPRK needs to engage in what it calls a "bold switchover"—away from nukes, crime, and repression as the pillars of the regime. Likewise it must abandon a bankrupt ideological concept of *Juche* (or self-reliance) and an Army-first state policy that is draining the economy dry. Instead, like China in the late 1970s and Vietnam in the late 1980s, North Korea must turn toward denuclearization, demobilization of the army, and economic and gradual political opening, in turn normalizing not just its relations but also its approach to the international community.

Fifth and finally: The members of the Six Party Talks - America included - need to offer to help North Korea transform. As with the case of Libya, we'll need to provide a clear roadmap of how this process will proceed, including the provision of large-scale economic support to rebuild and redirect North Korea's economy. The President has called on North Korea's leadership to make a positive strategic choice and offered a "bold approach" for transforming relations with the North. In 2004-2005 the North Korea Working Group at State developed a sophisticated and

comprehensive plan for helping North Korea structurally change in the context of implementing denuclearization and normalization steps with us and the other members of the 6-Party Talks. This plan is not about buying them off, it would entail projects aimed at fundamentally redirecting their economic and political system away from communism toward capitalism (as a conservative who wants to end the Cold War in East Asia I have no problem with that). Furthermore, this strategy would address the *needs* of their people (i.e. civilian industry/jobs/human rights), not the "wants" of their communist leaders (cash pay-offs/control). As Secretary Rice has said, "it's North Korea's choice to be isolated. If they stop engaging in hostile acts and start cooperating they will reap the benefits of engagement."

Some may see the US "sunshine and stick" policy today as a "high stakes poker game" that has sidelined all possibility for progress in the Six Party Talks. However, I believe it's a pretty shrewd betting strategy and feel that the DPRK will come back to the table. As we deal with the real North Korea, rather than the one we wish existed, I have confidence that the grounds exist for deep, sweeping, and serious progress in our relations with the DPRK and, in turn, its government's relations with its people and the outside world.

I am happy to answer any questions you or other subcommittee members may have. Thank you.

Actions to Halt North Korea's Illicit Activities  
Enhance  
Negotiations with North Korea

Statement

By Chuck Downs

Author, *Over the Line: North Korea's Negotiating  
Strategy*

Hearing before the Subcommittee on  
Federal Financial Management, Government  
Information, and International Security

Committee on Homeland Security and Governmental  
Affairs  
United States Senate

North Korea: Illicit Activity Funding the Regime  
April 25, 2006

I would like to thank the Subcommittee for inviting me to speak today and for its attention to this very important issue. I speak as a private citizen and author, and not in my capacity as a member of the board of the U. S. Committee for Human Rights in North Korea, of whose work I am very proud.

As other witnesses have said, North Korea's Kim regime is a criminal state. It is not unlike an organized crime family, but it is characterized by a higher degree of ruthlessness carried out on a scale that dwarfs the mafia's reach.

The Kim Jong-il regime's criminal character is evidenced not just in drug smuggling, human trafficking, counterfeiting, and money laundering, as bad as those activities are. North Korea is in many ways an extra-legal regime; that is, a regime that operates outside the bounds of its own laws and international agreements. Criminality permeates the North Korean state. Even North Korea's constitution itself is a cynical document, false on its face, purporting to vest presidential governing authority in a dead man, Kim Il-sung. Although his son Kim Jong-il is now the *de facto* dictator of North Korea, he pretends to occupy the unassuming position of deputy chairman of the National Defense Commission, a bogus title that obscures genuine lines of authority and permits him to shift accountability to others as he wishes.

Kim Jong-il punishes those he finds threatening in mock judicial proceedings that defy North Korea's own laws. He orders executions in public that children are forced to attend, in defiance of international standards of human rights. And he incarcerates thousands of political prisoners in a gulag he claims does not exist.

It should not be surprising a nation that subverts its own laws also defies its international obligations with impunity.

#### **Perceptions about North Korea are often at odds with reality**

North Korea is too often assumed to be fundamentally like other nations, deserving respect for its sovereignty and security concerns. The rest of the world may have no choice but to deal with the regime as a sovereign entity, but we should not lose sight that the North Korean "state" is actually a group of thugs.

North Korea's leaders cannot be assumed to operate within an institutional framework, beset as other leaders are, with competing domestic challenges. Over almost sixty years, the regime has systematically abolished the normal institutions of society—there is now no challenge to Kim Jong-il's power from any social organization, political party, military association, labor union, or religious organization. Even alumni associations are outlawed in North Korea. There is no freedom of assembly.

There is a clear peril in assuming that North Korea operates as other nations do. For example, many Americans might be expected to believe that North Korea's leaders, like other nations' leaders, seek to obtain benefits for their people. The assumption leads to an expectation that North Korea's leaders will negotiate in the interest of their subjects,



perhaps seeking some package of infrastructure or public works in exchange for honoring international standards of accounting for plutonium. In fact, the regime openly asserts in domestic propaganda that the relationship between the leader and its citizens is the other way around—that people exist to serve the leader. The people's welfare, even their access to food, is promoted only to the extent Kim Jong-il believes it serves his purpose.

The national interest is actually the interest of the *Suryong*, or supreme leader.

The case of North Korea's gold mines is especially informative. During the period of Japan's oppressive rule of Korea, mining companies were not able to extract gold from North Korea's gold mines economically. The cost of labor was too high, and the labor too dangerous and difficult, to make the mines worthwhile. Yet under the Kim regime—Kim Jong-il and his father—slave labor at the prison camps does the task. Satellite images of the prison camps, published in David Hawke's book *The Hidden Gulag*, put out by the U. S. Committee for Human Rights in North Korea, clearly identify the gold mines where the hapless victims of Kim Jong-il toil. The gold they have extracted has accrued to the personal treasury of Kim Jong-il. The gold can be shipped to China where gold certificates can be issued to obscure the regime's role. Gold certificates are as good as currency on the international market and are used to fund Kim's overseas operations, including villas in Europe and education for Kim's sons at exclusive schools in Switzerland. Estimates of the Kim families' wealth, based on what defectors and escapees have witnessed, range from \$4 billion to \$40 billion.

How, then, can the world call North Korea to task for its violation of international agreements? The answer lies in hitting at the heart of the dictator's own interests, the lucrative ill-gotten wealth.

#### **North Korea's Topsy-Turvy Approach to Negotiations**

It would seem obvious that an impoverished regime like North Korea might be solicitous of better relations with its neighbors, particularly China, given its reliance on China's financial and diplomatic support. North Korea, however, chooses to play the game differently. It poses threats to its neighbors and abuses China's forbearance, simply because it sees an advantage in doing so. North Korea correctly surmises that if it were not threatening, there would be little reason for any other nation to pay attention to it—few natural resources, no great achievements in the arts and industries, few cultural and tourist attractions—so North Korea finds that an ever-increasing level of aggravating behavior actually promotes its interests.

North Korea creates crises that make other nations want to bring North Korea to the negotiating table. Its own negotiating objectives, however, are always to (1) avoid agreements, (2) draw out the negotiations to wear down the other side's negotiators and win concessions, (3) demand concessions while yielding nothing in return, (4) get benefits just for agreeing to attend negotiating sessions, (5) block progress at the talks, and (6) sign on only to unenforceable arrangements that it will be able to subvert.

North Korea benefits during the process of avoiding negotiation because other parties will provide inducements and benefits if North Korea merely agrees to show up at talks. Negotiations are still viewed in a Cold War light, as another means of warfare, or as the Chinese expression went, “Talk, talk, fight, fight.” Contrary to the generally notion that a friendly atmosphere and cordial relations are a prelude to progress in negotiations, the North Korean regime observes that creating ill-will increases North Korea’s leverage and the other side’s sense of desperation.

North Korea’s pugnacity in negotiations gives the regime advantages in domestic politics as well. When North Korea acts like a bully on the international scene, it conducts purges at home. Kim Jong-il tightens his control by creating crises that give him rationales for demanding greater levels of loyalty and obedience.

#### **How Should the US Deal with North Korea?**

False hope that North Korea has recognized a need to reform often guides western negotiators’ approach to North Korea. From our perspective, it is inconceivable North Korea would not recognize the benefits of international cooperation. Yet history shows that inducements have not brought adjustments in the regime’s behavior; only adverse pressure has.

In the 1950s and 60s U. S. and U.N. negotiators concluded the way to deal with North Korea was to back up allied positions with a show of military resolve. As Admiral C. Turner Joy said regarding the Armistice negotiations, North Korea “can be compelled to negotiate seriously... only through the imminent threat of the application of our military power.”<sup>1</sup> In two crises, after the North Korean capture of the USS PUEBLO (1968) and the North Korean “axe murders” in the Joint Security Area (1976), North Korea responded to a show of military force—a deployment of a carrier battle group in 1968 and the introduction of bombers to South Korea in 1976.

Yet there have also been other types of pressure that have modified North Korea’s approach. In the 1970s and 1980s multilateral (usually UN and four-party talks) pressure had a role in modifying North Korea’s approach on North-South relations and eliciting some regret for North Korea’s terrorist attacks. In the 1990s, very promising formal agreements on denuclearization of Korea emerged from North Korea’s perception that changing international events (the fall of the USSR, the PRC’s recognition of South Korea) would have disadvantageous consequences.

Similarly, some progress in the six party talks a year ago came about from pressure that was consistently and, I would suggest, adroitly, exerted on the regime by the Bush administration. From February-May, 2005, increasingly critical statements from President Bush, Vice President Cheney, and Secretary of State Rice clarified U. S. impatience with North Korea’s failure to respond to an American proposal set out by Secretary Powell at negotiations in Beijing in June 2004. In early May, Bush administration negotiators cautioned North Korea that there would be consequences if

North Korea let a year pass without responding to the proposal on the table. In late May, the deployment of stealth fighters to South Korea inspired cautionary alarm from South Korea and China (both of which feared American military action). Eventually even North Korea concluded it could not let Washington's year-old proposal go unanswered. Kim Jong-il responded by proposing the resumption of talks a year and a month after the American proposal had been tabled. After numerous fits and starts, the six-party talks resumed, and in September yielded a reassuring but feckless statement from the regime, which it hastily redefined within a day.

Even such illusory achievements in negotiations with North Korea take tremendous resolve, coordination, and careful handling. But for real achievements, nothing is stronger than limiting the dictator's own purse strings.

On September 15, 2005, the Bush administration took action limiting access to the U. S. banking community for certain banks that "facilitated the criminal activities of North Korean government agencies and front companies." Not surprisingly, the regime, which had been delaying attendance at the talks, seized the negotiating session scheduled a few days later to condemn American interference in its affairs. Since that time, the negotiations have the appearance of being stalled. But it is likely that the results are better than we might have achieved in negotiating sessions.

#### **The Benefits of Cracking Down in the Regime's Illicit Activities**

Contrary to our natural inclination to promote a friendly environment prior to any international negotiation, taking adverse action against North Korea's illicit activities actually produced benefits for the negotiating process itself:

- It advanced multilateral unity against North Korea's unacceptable activities;
- It gave North Korea the impression that its leverage, gained by making threats and creating crises, was diminishing, at least for the near term.
- It chastened the regime's behavior and made it act, at least temporarily, compliant
- It sent North Korea a signal of American resolve in a way that Kim Jong-il understands
- It could not help but make Kim Jong-il wonder if there are ways the international community can take a closer look at his family's extravagance, and take action against assets he has scattered around the world.

Moreover, the action against a few banks had an effect on others, producing a multiplier effect. The action may well have thwarted certain North Korean illicit activities—sales of missiles and technology as well as the usual criminal undertakings—simply because these activities could not be funded.

The regime's negotiating behavior has been subdued since September—its diplomacy with China has been more solicitous, and it has soft-pedaled threats.

Even in a closed society like North Korea, information can spread by word of mouth. When North Korea's negotiators have to develop positions defending Kim Jong-il's illicit financial operations, new information begins to spread among the elite. While concerns cannot be expressed, there has to be a growing awareness that such activities embarrass the regime, imperil the continued flow of the benefits of the elite, and call into question Kim Jong-il's "genius." For the privileged North Koreans who find themselves in the nerve-wracking environment of Kim Jong-il's inner circle, fear that the Leader is not as great as he says presents a personally distressing psychological conflict. They cannot help but fear for their own security. Making the regime accountable for its criminal activities accordingly shakes the personality cult surrounding Kim Jong-il.

The law enforcement initiatives undertaken by the Bush administration have had an unusual impact inside North Korea. It specifically seems to have heightened the regime's fear of *military* opposition to Kim Jong-il. Since September, the regime has required all senior military officers to take loyalty oaths in public, something that had previously been done *pro forma* on certain military anniversaries. Inspection visits to military installations have increased, especially in this past month (April, 2006). It is also noteworthy that the threats usually made in the context of negotiations by political officials are being attributed to military leaders—that North Korea can increase its deterrent capabilities, and take pre-emptive action just as the United States can.

### Negotiating with the Criminal State

Negotiating with the North Korea criminal state is, not surprisingly, much like dealing with organized crime. The first thing they will do is threaten is your security, after which they will try to sell you protection, which they can revoke at their whim. They will be deceitful when they make agreements, and will violate them when they can. As with organized crime, the only way to deal with them successfully is through enforcement—direct pressure focused on ending the benefits of their crimes. Confronting North Korea on their lucrative illegal activities holds far more benefits than losses for regional security, and, in fact, it enhances the allied posture in the process of negotiation as well.

---

<sup>1</sup> C. Turner Joy, *How Communists Negotiate* (New York, McMillan, 1955), p. 175

STATEMENT OF

Marcus Noland, PhD  
Senior Fellow  
Institute for International Economics  
1750 Mass. Ave. NW  
Washington, DC 20036  
mnoland@iie.com

HEARING ON

NORTH KOREA: ILLICIT ACTIVITY FUNDING THE REGIME

25 April 2006

Subcommittee on Federal Financial Management, Government Information, and  
International Security  
Committee on Homeland Security and Governmental Affairs  
United States Senate

The views expressed in this statement are those of the author and do not necessarily reflect the views of individual members of the Institute for International Economics' Board of Directors or Advisory Committee.

It is an honor to be invited to testify before this subcommittee. Former Vice President Walter Mondale once told me that “anyone who calls themselves an expert on North Korea is a liar or a fool.” His cautionary admonition is particularly apt when discussing the netherworld of illicit activities. At the outset we should acknowledge that there is much that we do not know, and much of what we think we know is of uncertain reliability.

In this testimony, I would like to make a few basic points:

- The marketization of the North Korean economy over the past decade is best understood as a bottom-up process driven by the trauma of the famine. The government’s responses have been reactive and ambivalent.
- Illicit activities have long been part of the North Korean economy, but they appear to have intensified in the 1990s, as the North Korean economy went into decline and central government control began to fray.
- One can imagine several motivations for the US policy of impeding illicit activities by North Korea: upholding the law, increasing negotiating leverage in the context of the Six Party Talks, and encouraging regime change. Achieving the first goal is straightforward, but attaining the second depends on North Korea’s reaction, and attaining the third is subject to massive coordination problems, particularly with respect to China and South Korea.
- Inclusion of the Kaesong Industrial Complex in the upcoming free trade agreement (FTA) negotiations between the United States and South Korea will raise thorny issues related to the treatment of labor.

**Context**

Historically North Korea maintained a centrally planned economy along Soviet lines, remarkable only in the extent to which markets were repressed internally and its autarky. A famine in the 1990s killed up to 1 million North Koreans—nearly 5 percent of the pre-crisis population—equivalent of more than 13 million Americans today.

As North Korea's centralized system broke down and the state was no longer able to supply food, small social units—families, enterprises, and local political and military organs—began to exhibit a variety of coping behaviors to obtain food. The authorities responded by tolerating the development (and/or expansion) of informal markets. The market became the primary institutional mechanism through which most North Korean families obtained food.

Over time the institutional infrastructure of a market—wholesalers, middlemen, retail vendors, and others—emerged, and what began with food gradually encompassed a broader range of household goods. As this process developed, and consumer goods from China began to enter the market, opportunities for arbitrage arose and the central planners lost control over the economy.

This phenomenon had profound implications for the state because it had been raising revenue primarily through transaction taxes administered through the central plan. The government faced a fiscal crisis created by the collapse in revenue combined with high expenditures including on a bloated military—over 1 million troops in a country of perhaps 22 million people, making it the world's most militarized society. In July 2002

the government introduced a system of direct taxation to reconstruct its fiscal base, but implementation has been problematic, and the country remains plagued by high, sustained inflation.

North Korean policymakers have continued to extend these reforms, and it would not be correct to leave you with a completely negative impression, but it is fair to say that the reforms have been a mixed bag, not delivering as expected and contributing to increasing social differentiation and inequality. Like a surfer, the North Korean state is perched precariously atop a dynamic, changing foundation.

#### **Role of Unconventional Activities in the North Korean Economy<sup>1</sup>**

After defaulting on international creditors in the 1970s, North Korea was frozen out of international capital markets, and came to rely increasingly on aid from fraternally allied socialist states, remittances from ethnic Koreans in Japan, and illicit activities such as drug trafficking and counterfeiting to generate foreign exchange. Aid declined from the mid-1980s on, as did remittances, which are likely to be well under \$100 million today.

As these sources of hard currency revenues withered during the 1990s, North Korea's dependence on a variety of illicit activities intensified. One could interpret them as either a grasping response to deteriorating economic conditions or a loss of government control permitting the rise of non-state sanctioned activities, or both. While the bulk of these illicit activities appear to have been undertaken at the direction or with

---

<sup>1</sup> This section draws on Stephan Haggard and Marcus Noland, *Famine in North Korea: Aid, Markets, and Reform*, Columbia University Press, forthcoming, Appendix A.



the knowledge of the top leadership, more recent episodes suggest that at least some of these activities are more decentralized and involve complex transnational relations between various state entities and criminal networks.<sup>2</sup>

North Korea's diplomatic corps has long been under pressure to support the maintenance of foreign missions by earning foreign exchange. One of the simplest ways of doing so is to exploit diplomatic immunity, including most importantly the international conventions that protect the secrecy and integrity of the diplomatic pouch. During the 1970s, police in all four Scandinavian countries found that North Korean embassies were using their diplomatic tax exemption to purchase alcohol and cigarettes in large quantities and then reselling them on the black market.

Far more lucrative, however, was trafficking in drugs—in essence acting as couriers for drugs produced by others.<sup>3</sup> Sheena Chestnut documents not only how total drug seizures went up sharply after 1996—the peak of the famine—but also how the personnel involved in seizures came to include officials outside the foreign ministry (economic and intelligence officials) or without any clear official designation (employees of trading companies) as well as members of Asian criminal organizations that were acting as partners or intermediaries. Also, North Korea began to produce drugs for export

---

<sup>2</sup> See Sheena E. Chestnut, 2005. “The ‘Soprano State’: North Korean Involvement in Criminal Activity and Implications for International Security,” Honors Program for International Security Studies, Center for International Security and Cooperation, Stanford University, May 20, for an exhaustive overview culled from public sources. For earlier documentation, see Marcus Noland, *Avoiding the Apocalypse: The Future of the Two Koreas*, Washington: Institute for International Economics, 2000.

<sup>3</sup> See Noland, op cit., and Raphael Perl, 2005. “Drug Trafficking and North Korea: Issues for U.S. Policy,” *CRS Report to Congress*. Washington: Congressional Research Service (March 4).

from the mid-1990s, beginning with opium but diversifying into methamphetamine and other synthetics following the floods of 1995.

Although drugs almost certainly dominate North Korea's smuggling activity, there is evidence—in the form of diplomatic expulsions—of trade in other sanctioned items, including conflict diamonds, rhino horns, and ivory.<sup>4</sup> To my knowledge, North Korea is the only government to ever be issued a formal demarche by the secretariat of the Convention on International Trade in Endangered Species for its diplomats' activities in this regard.

The second major form of illicit activity is counterfeiting. US government officials had long suspected North Korea to be the origin of the so-called supernotes, very high-quality counterfeits of \$100 bills, which began to appear in 1989.<sup>5</sup> As with drug smuggling, the sale of supernotes involves a complex “wholesale” and “retail” distribution chain. Seminal developments were two sting operations in the United States and the 2005 indictment of Sean Garland, leader of an IRA offshoot, and a Treasury Department finding that Banco Delta Asia in Macau was a financial institution of “primary money laundering concern” under the 2001 USA Patriot Act. In the wake of the finding, pressure from correspondent banks in Japan, Korea, and Europe, and a run on the bank, Banco Delta Asia severed connections with 40 North Korean individuals or businesses, replaced several managers, and allowed a panel named by Macau's

---

<sup>4</sup> See Noland, op. cit., and David L. Asher, “The North Korean Criminal State, its Ties to Organized Crime and Possibility of WMD Proliferation,” Nautilus Institute Policy Forum Online 05-92A (November 15), available at <http://www.nautilus.org/fora/security/0592Asher.html>

<sup>5</sup> See Noland, op. cit., and Raphael Perl, 2006. “North Korean Counterfeiting of U.S. Currency,” *CRS Report to Congress*. Washington: Congressional Research Service (March 22).

government to administer its operations. Counterfeiting has not been limited to currency: Evidence also exists of North Korean involvement in counterfeiting of cigarettes and pharmaceuticals.

North Korea's weapons trade has attracted considerable scrutiny, though it is arguably not "illicit." North Korea sells missiles and base technologies for them that fall under the Missile Technology Control Regime, but it is not a party to that agreement. Customers of North Korean missiles or missile technology include Libya, Pakistan, Iran, Egypt, Syria, and Vietnam.<sup>6</sup>

Calculating the size of these unconventional activities is difficult. Such trade is likely to be more volatile than other economic activities, thus an estimate for any given year can be highly misleading. Seizures and arrests that appear to show very large amounts of trade—such as Japanese seizures of methamphetamine in 1998–2002 with a wholesale value of \$75 million or the Garland indictment—can be followed by the breakup of networks and a sharp fall in trade. Large military sales are "lumpy" as well; successful exports to a particular country do not necessarily generate ongoing business of the same magnitude. A reported statement by a US official in 2002 put sales in 2001 alone at \$560 million, but it is unclear how the US government estimates the value of such transactions or associated after-sales service, and the customer base may have subsequently shrunk as well.

David L. Asher concludes on the basis of an analysis of North Korea's external accounts that total criminal activity and military sales in 2003 could have accounted for

---

<sup>6</sup> See Noland, op. cit., and Bertil Lintner, *Great Leader, Dear Leader: Demystifying North Korea under the Kim Regime*. Chiang Mai, Thailand: Silkworm Books, 2005.

as much as 35 to 40 percent of all North Korean trade and an even higher share of total cash earnings. This number is broadly in line with my earlier estimate of about one-third of all balance of payments revenue, derived in declining order of importance from military sales (undesirable from a US policy standpoint though not illegal), drug trafficking, counterfeiting, and smuggling.

Finally, the invitation letter to testify at this hearing mentions “slave labor” as one of the Subcommittee’s concerns. Apart from abysmal practices internally, North Korea “exports” labor, primarily to logging camps in Russia and manufacturing establishments in Eastern Europe. Working conditions are dire.

Probably the largest potential source of labor-related income however, comes from the Kaesong Industrial Complex, where the North Korean government derives hard currency revenues from leasing income, taxes, and workers’ wages paid by South Korean firms. Thus far the North Korean government has probably earned less than \$20 million from these revenue streams, the bulk derived from the land lease agreement, but if the South Korean government is successful in realizing its ambitious expansion plans, taxes alone could rise to nearly \$1.8 billion by 2017, and would dwarf the illicit revenue streams discussed today.<sup>7</sup>

### **Implications for US Policy**

Anecdotal evidence suggests that the US policy of impeding illicit transactions is having some effect on legitimate commerce, if not the illicit activities themselves: foreigners

---

<sup>7</sup> Mark Manyin, presentation at KEI/AEI conference “Strategic Implications of Economic Engagement with the DPRK: Kaesong and Beyond,” April 18, 2006.

engaged in business in North Korea report increasing difficulty in executing financial transactions due to the reluctance of foreign financial institutions to deal with North Korean counterparties, and the decline in the black-market value of the North Korean won has accelerated, suggesting that the supply of foreign exchange—derived from both these licit as well as illicit activities—is drying up.

If law enforcement is the sole aim of US policy, then the collateral damage done to legitimate commerce is regrettable—inflicting pain indiscriminately, reducing sources of wealth, power, and influence beyond direct central control, and creating diplomatic tensions with third parties. Such concerns are equivocal if the goal is to encourage North Korea to negotiate more seriously in the context of the Six Party Talks. If the idea is simply to strangle the North Korean economy in an attempt to induce regime change, then maximal damage is desirable.

My research demonstrates that the North Korean regime is susceptible to external economic pressure; such coercion in combination with positive incentives may elicit the desired reaction in terms of North Korean negotiating behavior.<sup>8</sup> However, a more ambitious policy of seeking regime change through economic distress immediately runs into obstacles, particularly with respect to China and South Korea. These countries prefer the maintenance of the status quo to instability and can offset pressure from the United States and others. In the absence of some kind of coordination with these countries, US pressure is unlikely to achieve its political goals, while inflicting misery on North Koreans, who have no control over their government, and worsening diplomatic relations with other countries. Moral outrage—however justifiable—is not a policy.

---

<sup>8</sup> Marcus Noland, *Korea After Kim Jong-il*, Washington: Institute for International Economics, 2004.

Labor issues could arise in US policy in the context of the upcoming FTA negotiations with South Korea. South Korea has requested duty-free treatment for products produced in the Kaesong Industrial Complex in prior FTA negotiations with other trade partners. If included in the upcoming negotiations, it will create a thorny issue with respect to labor standards. The issues are twofold.

The first is substantive: North Korea does not meet internationally recognized core labor standards—rights to associate, organize, and bargain collectively are absent entirely. At Kaesong, workers are not hired directly—instead they are hired through a North Korean government agency, which, according to South Korean government sources, retains \$22.50 of a worker's \$57.50 monthly pay to cover social security payments as well as transportation and other in-kind benefits.<sup>9</sup> However, while South Korean firms pay in hard currency, North Korea pays the workers in North Korean won converted at the wildly overvalued official exchange rate. Evaluated at the more realistic black-market rate, North Korean workers net less than \$2 per month. The real problem is that while conditions in Kaesong may be exploitative, they probably are considerably better than those existing elsewhere in North Korea, and there may be no shortage of North Koreans willing to work on these terms.

The second issue is procedural: While the FTA will presumably include a labor standards chapter, South Korea has no way to enforce such commitments in Kaesong, where North Korea is sovereign. One possible solution would be to involve a third party

---

<sup>9</sup> This figure is for a 48-hour workweek. The South Korean government reports that with overtime, the actual workweek averages 55 hours and workers on average receive \$67 dollars of gross pay, before deductions.

such as the International Labor Organization (ILO) to monitor conditions in the zone and certify compliance with agreed standards as was done in the Cambodian textiles case and has been floated by Jay Lefkowitz, President Bush's special assistant for North Korean human rights. But even this solution would require the cooperation of the North Korean government, which is not a member of the ILO, has a track record of noncooperation in other spheres of international engagement, and to date has restricted access to the zone by third-party observers.

In sum, the controversy over Kaesong, and in certain respects the related concerns about illicit activities addressed in the hearings today, echo the practical and ethical dilemmas that the humanitarian community has confronted for more than a decade in responding to hunger issues in North Korea: namely how to do right by the North Korean people who are victimized by a political regime over which they have no control and that in large part embodies values antithetical to our own and how to devise effective policies in a context in which the national priorities of some influential countries differ from those of the United States.

**Questions for the Record Submitted to  
Dr. Peter Prahar by  
Senator Tom Coburn (#1)  
Senate Committee on Homeland Security and Governmental Affairs  
Subcommittee on Federal Financial Management, Government  
Information, and International Security  
April 25, 2006**

**Question:**

In your testimony, you stressed that the Department of State cannot verify the level of drug production occurring within North Korea. Why can't our satellite technology detect the opium fields and provide the intelligence needed for better estimates?

**Answer:**

The Department will provide an answer under classified cover to this question.



**Questions for the Record Submitted to  
Dr. Peter Prahar by  
Senator Tom Coburn (#2)  
Senate Committee on Homeland Security and Governmental Affairs  
Subcommittee on Federal Financial Management, Government  
Information, and International Security  
April 25, 2006**

**Question:**

What steps is the State Department taking to engage European allies like the Czech Republic, Poland and Bulgaria regarding eye-witness reports of forced labor farms and factories located in their countries but owned and operated by North Korea? What are the binding treaties and commitments associated with the Commission on Security and Cooperation in Europe that demand a response of these countries to confront North Korea's trafficking in persons? Why doesn't the Trafficking in Persons report mention the North Korean forced labor occurring within these countries?

**Answer:**

The Czech Republic and Poland have investigated reports that persons from the DPRK are being forced to work under unlawful conditions and to date have found no violations of EU laws or international standards. These investigations are ongoing. In the case of Bulgaria, media speculation that North Korean workers are present in the country has not been substantiated through any independent investigations.

We include the topic of North Korea and the presence of North Korean workers on the agenda for bilateral discussions with each of these three countries, as well as with other European allies.

Norms and commitments concerning trafficking in persons that have been agreed to by all participating States of the Organization for Security and Cooperation in Europe (OSCE) are not legally binding. The OSCE Anti-Trafficking Action Plan places responsibility for meeting these commitments on countries themselves.

The presence of North Korean workers in European countries was addressed in the 2006 Human Rights Report (for the Czech Republic) and will be addressed as well in the 2006 Trafficking in Persons Report (in both the DPRK and Czech Republic country narratives).

**Questions for the Record Submitted to  
Dr. Peter Prahar by  
Senator Tom Coburn (#3)  
Senate Committee on Homeland Security and Governmental Affairs  
Subcommittee on Federal Financial Management, Government  
Information, and International Security  
April 25, 2006**

**Question:**

On October 19, 1998, the Congress passed H. R. 4328, the Fiscal Year 1999 Omnibus Appropriations Act (PL 105-277). This act mandated "a full and complete interagency review of United States policy toward North Korea." Section 582 (e) of that Act stated, "Not later than January 1, 1999, the President shall name a 'North Korea Policy Coordinator,' who shall conduct a full and complete interagency review of United States policy toward North Korea, shall provide policy direction for negotiations with North Korea related to nuclear weapons, ballistic missiles, and other security related issues, and shall also provide leadership for United States participation in KEDO." Can you describe how the State Department is currently carrying out this statute? Is there an officer that is coordinating a comprehensive policy on North Korea that includes illicit activities and weapons proliferation, who is this person, and does this person operate out of the Secretary's office as was the case during the first half of the Bush Administration?

**Answer:**

The Illicit Activities Initiative, an institutional arrangement that in June 2005 replaced the previous North Korea Working Group, is an interagency process to coordinate USG efforts against, and share information about, North Korean criminal activities. It involves cooperation

through a number of inter-departmental working groups to deal with elements of North Korean criminality, including smuggling, narcotics trafficking, money laundering and counterfeiting, as well as abuses of diplomatic privileges.

These working groups report findings and developments, and make policy recommendations to officials at their respective agencies. More than a dozen offices and agencies participate in the Illicit Activities Initiative, including the Department of Justice, Federal Bureau of Investigation, Department of the Treasury, United States Secret Service, Drug Enforcement Administration, Department of Homeland Security/Immigration and Customs Enforcement, Department of Defense, and Department of State.

The Working Groups of the Illicit Activities Initiative report to an interagency Policy Coordinating Committee chaired by Assistant Secretary of State for East Asian and Pacific Affairs Christopher R. Hill, and through that body to U.S. government Deputies and Principals. A separate Policy Coordinating Committee (PCC) under the direction of the Department's International Security and Nonproliferation Bureau has responsibility for policy coordination on efforts to counter the DPRK's proliferation-related activities. This PCC also reports to U.S. Government Deputies and

Principals. On the Korean Peninsula Energy Development Organization (KEDO), the interagency USG approach – dating from the decision of the DPRK to expel International Atomic Energy Agency inspectors and withdraw from the Non-Proliferation Treaty – has been to urge that the organization's Light Water Reactor project be terminated. The KEDO Board agreed to that proposal in November 2005, and agreed in principle to close the organization as soon thereafter as practical.

**Questions for the Record Submitted to  
Dr. Peter Prahar by  
Senator Tom Coburn (#4)  
Senate Committee on Homeland Security and Governmental Affairs  
Subcommittee on Federal Financial Management, Government  
Information, and International Security  
April 25, 2006**

**Question:**

What is the status of the currently empty position of Special Envoy to the Six-Party Talks? When will this position be filled, and who is the current candidate?

**Answer:**

The position of Special Envoy has been vacant since Ambassador Joseph DeTrani departed in January of 2006 to take up a position under the Director of National Intelligence, Ambassador John Negroponte. We are considering candidates to replace Ambassador DeTrani and hope to name a new Special Envoy soon.

**Deputy Assistant Director Michael Merritt, United State Secret Service**  
 Department of Homeland Security

1. Would it make the Secret Service's job of protecting US currency easier to deny foreign companies access to US currency technology—much like many of our allies? What can Congress do to better equip the Secret Service in this vital service?

Currently, the US Secret Service is pursuing a policy of disruption for the counterfeit notes being manufactured by the North Korean Government. In order for the Secret Service to try to curtail the production of US currency by the North Koreans, the Service has been meeting with the banknote and security printing industries to inform them of the illicit activities by North Korea and request they voluntarily stop supplying currency related materials to them. In furtherance of this initiative, the Service has solicited the assistance of INTERPOL. After briefing INTERPOL on the unclassified evidence against North Korea, INTERPOL hosted a meeting with the key companies in the banknote industry to provide the Service with a venue to present the information and officially request the voluntary restriction of security printing materials and equipment to North Korea. Subsequent to this meeting, INTERPOL issued an "Orange Notice" regarding North Korea's involvement in the counterfeiting of US currency and the request of voluntary restriction of security printing materials and equipment. This notice was made available via the INTERPOL website to member law enforcement entities. To date, this notice has not been officially forwarded to the targeted industries, diminishing the effectiveness of the effort. The Service is currently involved in discussions with INTERPOL to strengthen the language of the "Orange Notice" and expand its distribution to include all security printing industries. The broad dissemination of the "Orange Notice" will at least generate new investigative information as to the items that the North Koreans are attempting to acquire, but may also prevent the North Koreans from increasing their capabilities and/or capacity to counterfeit US or other currencies.

Because neither the US Secret Service nor INTERPOL has the ability to restrict commerce, any requests that we make regarding curtailing the sales of banknote materials is strictly voluntary. In order for the Service to pursue an effective disruption campaign, formal restrictions against North Korean acquisition of security printing equipment and supplies is required. Although some companies within the security printing industry have been extremely cooperative in the US efforts to prevent further counterfeiting by North Korea, others have been reluctant partners, while still other companies have refused to discontinue their relationship with North Korea. Official regulations regarding the sale of restricted items of both US and foreign companies are needed to restrict the flow of supplies to the North Korean counterfeiting operation. These regulations would need to prohibit any company from conducting business within the US or with US interests that also brokers, sells or supplies security printing equipment, services, materials, or consumables to North Korea.

In addition to security printing equipment and materials restrictions, the US Secret Service would benefit from the modification of 18 USC 470. The inclusion of conspiracy within this extraterritorial counterfeiting law would greatly enhance the Services ability to prosecute the various levels of individuals involved with the distribution of the "Supernote".